

2553
No. 12054

United States
Court of Appeals

for the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

VS.

WESTVACO CHLORINE PRODUCTS COR-
PORATION, a corporation,

Appellee.

Transcript of Record

(In Three Volumes)

VOLUME II

(Pages 457 to 900, inclusive)

Appeal from the United States District Court
for the Northern District of California
Southern Division

FILED
FEB 16 1949

No. 12054

United States
Court of Appeals
for the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS COR-
PORATION, a corporation,

Appellee.

Transcript of Record

(In Three Volumes)

VOLUME II.

(Pages 457 to 900, inclusive)

Appeal from the United States District Court
for the Northern District of California,
Southern Division

(Testimony of C. Bruce Flick.)

Q. That is one of the items that is included in overhead expense by Westvaco, is it?

A. Yes.

Q. Then as to any unaccounted for time or services in the laboratory, such as you have in the shipping department, say a laboratory superintendent, you would object to any charge of that character against gypsum because it would have to be allocated on some basis, is that right?

A. No, if gypsum is considered—We are talking now about joint products.

Q. No, I am talking about gypsum. You just conceded that direct charges would be proper although gypsum is a by-product, is that right?

A. Yes.

Q. On the same hypothesis, assuming without conceding that gypsum is a by-product, if I understand your testimony, then, you would not object to the direct charges, but you would object to indirect charges, such as the salary of a laboratory supervisor, for the reason that you would have to allocate that on some basis, is that right?

A. For the reason that the basis principle of by-product—

Q. Do not give me the reason—

Mr. Bennett: Let him answer. [427]

Mr. Rosenberg: He is saying "for the reason." I do not know if he is answering "Yes" or "No," yet.

Mr. Bennett: After all, you are not testifying, Counsel. Let the witness testify.

(Testimony of C. Bruce Flick.)

The Court: Just a moment. Let the reporter read the question.

(Question read.)

A. Not for the reason that you have to allocate, but for the reason that if you quit making the by-product you would still have that expense.

Q. (Mr. Rosenberg): Let us take accounting. There is an accounting department at the Newark plant, is there? A. Correct.

Q. And a portion of their services are devoted to the keeping of records and invoices and checking your debit memos and things of that sort pertaining to gypsum, is that right?

A. I assume so.

Q. Is it your position that no part of that expense is properly chargeable to gypsum?

A. No part of that expense which you would have anyway if you quit making gypsum is properly chargeable to the by-product gypsum.

Q. Let us assume that we would hire a girl to do nothing but keep the accounts and the records pertaining to gypsum, although it might not require her full time. Then under those circumstances you would say that that would be a proper expense to gypsum, would you?

A. Not a part of cost of manufacture. She is not manufacturing gypsum and there would be perhaps a question as to the nature of the accounting work she did. If she is checking our debit memos, she is not manufacturing gypsum.

Q. But it would be a proper expense?

A. Not as part of cost of manufacture. It would be an overhead item.

(Testimony of C. Bruce Flick.)

Q. Let us take this question as an expert question, forgetting about Westvaco.

The Court: Pardon me.

Mr. Rosenberg: Yes, your Honor.

The Court: He said it would be an overhead.

Mr. Rosenberg: Oh, it would be an overhead.

The Court: Isn't that the answer?

Mr. Rosenberg: That is the answer.

The Court: Pardon me. I do not want to inject myself.

Q. That would be a proper charge on overhead?

A. That would be what we call an overhead. I am distinguishing between that and the cost of manufacture.

Q. Yes, but it would be a proper charge?

A. To overhead. Now, there is a further question as to allocating it, or whether it should be allocated at all.

Q. (Mr. Rosenberg): As I have understood your previous testimony, Mr. Flick, you have conceded, have you not, that ordinarily, [429] and eliminating any question of a by-product, overhead is a proper item to be included in determining cost of production, isn't that true?

Mr. Bennett: In the case of a principal or co-product.

Mr. Rosenberg: I said, eliminating a by-product.

Mr. Bennett: Oh, not in the case of a by-product.

Mr. Rosenberg: May that answer go in as the witness' answer, Mr. Bennett?

(Testimony of C. Bruce Flick.)

Mr. Bennett: I wanted to get the question clear. Apparently there is some confusion about it. You are reviewing the situation. The witness has stated, as I understand, several times that there is a definite line and difference between——

The Court: If there is any question about it, clear it up in your own way.

Mr. Bennett: ——including overhead allocations he says proper.

Mr. Rosenberg: Mr. Bennett, may I ask the witness rather than you?

Mr. Bennett: Well, all right, I will have to object perhaps to the form of the question.

The Court: There is nothing before the court at this time. Let us proceed.

Q. (Mr. Rosenberg): As I correct in stating that you have stated as an expert that in the manufacture of a principal product or the manufacture of joint or co-products, overhead [430] expense is properly included in determining cost of production?

A. That is, the overhead expense right at the plant where the product is made.

Q. That is true, is it?

A. Yes. We have exemplified that by Gerlach.

Q. One of the things you mentioned is we included in overhead our personnel department that had to do with employing people and getting deferments for them during the war, and if I can cut this short, will you tell me whether I am correct in this, that you would agree that that would be a

(Testimony of C. Bruce Flick.)

proper expense in the case of a major product of a co-product but you believe that it is improper in the case of a by-product, is that right?

A. Correct, because you would still have it if you quit making the by-product.

Q. Yes. Now, when you were testifying the other day you stated that you felt that the sulphuric acid charge was not a proper charge to the cost of production of gypsum, and one of the reasons that you gave is that Dr. Seaton stated in his article, which we have referred to previously, the sulphuric acid was added because the bittern had a slight and variable alkalinity which made its processing difficult. Now, therefore, if you are primarily producing a major product and you have this material to make the processing, to facilitate the processing for the major product, again should not be charged as cost of manufacture of the by-product. Do you remember giving that testimony? [431]

A. I believe so.

Q. What major product were you talking about when you said that Dr. Seaton said sulphuric acid was necessary to the manufacture of a main product?

A. The point I had in mind is this, that the sulphuric acid being added to the bittern to improve the condition of it for its further processing would perhaps facilitate the removal of the impurities, which would thereby benefit the main product.

Q. What main product were you talking about?

A. Magnesium oxide, for which the plant was primarily designed.

(Testimony of C. Bruce Flick.)

Q. Isn't it a fact that when Dr. Seaton made the statement to which you referred he was not talking about magnesium oxide at all, was he?

A. He was talking about the whole plant operation.

Q. Was he? A. Certainly.

Q. Show me where he said that.

A. He described first the bromine and then the magnesium oxide and then he referred to the by-product gypsum.

Q. Where is the statement to which you referred when you said that Dr. Seaton said that the sulphuric acid was added because the bittern had a slight and variable alkalinity, which made its processing difficult.

A. "The raw bittern has a slight and variable alkalinity, which makes its further processing difficult. Accordingly, from the [432] storage ponds, it is pumped to a large surge tank, from which it issues as a controlled stream into which the necessary quantity of concentrate sulphuric acid to give essential neutrality is introduced by a proportioning pump?

Q. Isn't it true, Mr. Flick, that that which you just read is a portion of a paragraph commencing as follows:

"Recovery of bromine from bittern, is carried on at all three plants of the California Chemical Corporation,"—

And isn't it true that from that point on Dr. Seaton went on to discuss and explain the process for

(Testimony of C. Bruce Flick.)

the recovery of bromine, and that the excerpt that you just read had relation to Dr. Seaton's dissertation upon the recovery of bromine rather than magnesium oxide, isn't that true?

A. Bromine was the beginning of the dissertation. He did not stop with bromine. Let me read this:

"Exit liquor from the bromine recovery towers has essentially the same composition as the raw bittern with the exception that its small bromine content has been replaced with chlorine. Some 3 percent dilution by condensed steam also has occurred. Both Newark and Chula Vista plants process this liquor for magnesium chloride recovery."

Q. Now, you have been over the plant and, as explained before, there are three processes: The first one is bromine. The bittern first goes to the bromine plant, isn't that correct? [433]

A. That is what I understood, yes.

Q. After it leaves the bromine plant and the bromine has been recovered it goes to the gypsum plant, does it?

A. That is my understanding.

Q. And what Dr. Seaton was talking about——

A. You are using the present tense. It should be the past tense, because they are not making the bromine now, are they?

Q. No, they are not. As a matter of fact, at the time this article was written in 1931 they did not even have a plant for gypsum and magnesium, did they, at Newark?

(Testimony of C. Bruce Flick.)

A. They were making gypsum then, were they not?

Q. In a pilot plant, were they not?

A. Yes, the basic process is the same.

Q. They were not making commercial gypsum, were they?

A. I really do not know in 1931, but he refers to it. I understand the chemical process was the same.

The Court: It is time for adjournment. We will adjourn until two o'clock.

(A recess was thereupon taken until two o'clock p.m.)

Tuesday, December 16, 1947, 2:00 p.m.

C. BRUCE FLICK

resumed the stand.

Cross Examination (Continued)

The Court: You may proceed.

Q. (Mr. Rosenberg): Mr. Flick, getting back to this Newark plant, as I stated before, when the bromine towers are working, there is a process that precedes the first process that is shown on here, that is taking bittern water and recovering the bromine from it.

A. That is my understanding.

Q. All of these processes at the Newark plant start in with this bittern water; is that correct?

A. Yes. The bittern water comes in and goes through the bromine towers when they are operating and then on to the next stage and so on.

(Testimony of C. Bruce Flick.)

Q. Then to gypsum and then to magnesia. This bittern water is, I believe you explained the other day, concentrated sea water that remains after the Leslie Salt Company has taken salt out of the sea water?

A. That is my understanding.

Q. That bittern itself, that is the residue, we might say, that remains in the Leslie Salt plant after they have taken salt out; is that right?]435]

A. I think so.

Q. And it is something that is simply incidental in the Leslie Salt plant from the production of salt?

A. Well, I hesitate to talk about the Leslie Salt, because I really don't know their operation.

Q. Well, assuming their process is to take the sea water and collect it in ponds and let it lie there until a certain portion of the natural salt has been precipitated, then they take off the remaining water which is the bittern and collect the salt; assuming that to be the fact, this remaining liquid, which is bittern, that would be a by-product of the Leslie Salt Company, wouldn't it?

A. It sounds like it.

Q. So in the Newark plant, as a matter of fact, the processes start with the use of a liquid that is in itself a by-product of another plant; is that right? A. That may well be.

Q. And as far as the Leslie Salt Company is concerned, that bittern water would be a valueless waste, would it not, unless they sold it to Westvaco? A. Well, I don't know.

(Testimony of C. Bruce Flick.)

Q. You know of no other use that it would have?

A. I don't know; I am just ignorant about its alternate uses for sale of the bittern water. I understand that the bittern water is sold to Westvaco. As far as other alternatives, I [436] really don't know.

Q. Well, it would have no commercial use as such unless something were done to it, would it?

A. I don't know that.

Q. Well, assuming that to be the fact, you do know this, don't you, that common salt—what is the chemical term, is it sodium chloride?

A. Sodium chloride, I believe.

Q. The bittern that comes to the Westvaco plant after Leslie has taken out, we will say, most of the sodium chloride, contains certain chemicals, does it? A. Yes.

Q. It contains—what does it contain, do you know?

A. It contains several elements. The article of Dr. Seaton that we spoke of shows two analyses and says that it contains among other elements magnesium sulphate and chloride.

Q. At least to the extent that your answers have indicated the processes at the Newark plant may be distinguished from the process at the Gerlach plant; is that a fact?

A. Very definitely.

Q. In other words, you stated in your testimony of the other day, I believe, that the Newark

(Testimony of C. Bruce Flick.)

plant you start with your mined quarried gypsum, that is a product that is naturally of some value whether you process it or not, there is no stage of the production where you have a valueless raw material; is [437] that what you stated the other day?

A. You misspoke yourself. You said Newark. You meant Gerlach.

Q. Yes. Gerlach.

A. At the Gerlach plant we start with rock which is brought out from the quarry and the distinction that I was trying to make, the apparent distinction was that at no time in the Gerlach production of joint products is there a removal of waste from which any product results or from which any product is produced, whereas at the Newark plant the by-product gypsum is made by drying and grinding something which would be a valueless waste if it were not processed.

Q. In other words, you said in your testimony the other day that at no stage of the process at the Gerlach plant do you have a valueless raw material because the gypsum could be sold as such for agricultural purposes without being processed——

A. Yes, you could grind up gypsum rock and sell it. Gypsum deposits are there and people may be permitted to come and get it and pay for it and haul it away.

Q. Will you concede that there is some distinction in these processes in this chemical plant at Newark in that the basic material from which you

(Testimony of C. Bruce Flick.)

start all your processes is in itself a valueless waste material?

A. No, it is not valueless because it is being sold for money to Westvaco. [438]

Q. That, in your opinion, alters it from being a valueless waste, is that it?

A. Well, it obviously has value if Leslie Salt Company collects dollars for it.

Q. The same is true of gypsum, isn't it?

Mr. Bennett: That is argumentative.

Mr. Rosenberg: Withdraw that.

Mr. Bennett: In fact, gypsum after it is ground and dried is, of course, of value. That is the very basis of this contract.

Mr. Rosenberg: May I have Exhibit 4, please?

The Witness: Your Honor, may I revert for a moment to an answer just before the recess?

The Court: Yes.

The Witness: Just before the recess we were speaking of the bittern going through bromine towers and then on to the next stage and on to other steps and on to the gypsum plant. What I have in mind always when I use the term "the gypsum plant" is the unit where the drying and grinding occurred, and obviously, the bittern never goes on to that gypsum plant. I just wanted to be sure the record does not show the confusion. The bittern goes first to the bromine towers when they are in operation and then on to the next stage in the process. The bittern never goes to what we understand is meant by the term "gypsum plant."

(Testimony of C. Bruce Flick.)

The gypsum plant, as I understand it, is the [439] unit in the plant where the gypsum is ground and dried and, obviously, the bittern never goes there.

Q. (By Mr. Rosenberg): But the bittern goes to the tower, the precipitation vats where the bittern is precipitated out of the fluid, is that right?

A. The bittern is not precipitated.

Q. I mean the gypsum.

A. The bittern goes into the big tanks where the gypsum is precipitated and then you still have to filter out the material from which the byproduct gypsum is made which, as I understand it, is the filter cake.

Q. Now, throughout your testimony you have stated that, according to good accounting principles, in determining the cost of a byproduct, overhead should not be included. That is the substance of your statement?

A. That is a good general principle.

Q. Will you tell me what authority you have for that opinion, Mr. Flick; have you read text writers or articles or court decisions, or what is the basis for your expert opinion as to what is good accounting practice for byproducts?

A. Well, I think that initially I indicated my education and my experience, like with the study of accounting at the University of California under Henry Rand Hatfield and John F. Forbes, subsequent employment with Haskins & Sells, one of our best known national public accounting firms and many years of [440] experience as an accounting

(Testimony of C. Bruce Flick.)

and financial, fiscal officer in corporations where they dealt with different companies for the purpose of audit, Price, Waterhouse & Company, Lybrand Ross Bros. & Montgomery, or Haskins & Sells, and in general an acquaintance with most of the accounting profession such as George P. Carruthers and George Keast and various others, and my own background, naturally, in the course of those years and reading periodicals and one thing and another.

Q. You do read articles and periodicals on cost accounting, I presume?

A. From time to time.

Q. Can you refer us to a treatise or text writer who has stated, as you have, that in determining cost of production of a byproduct, it is improper to include overhead?

A. I cannot quote you at the moment any particular citations.

Q. In other words, you have no authority for your opinion that you can designate at this time except your own individual opinion placed against the background that you have just mentioned of your experience and contacts with other persons in the profession; is that it?

A. I am not prepared to cite specific authorities at this moment.

Q. Let me ask you if you will disagree with this statement, Mr. Flick. [441]

The word byproduct is troublesome in accounting terminology. Frequently byproducts are of con-

(Testimony of C. Bruce Flick.)

siderable value. They may even be worth more than the so-called main products from which they derive. In byproduct coke operation the coke produced sells for less than the cost of the coal from which it is made. The implication in the word "byproduct" that a product is merely nominal because it is incidental to the obtainment of some other may lead to superficial accounting treatment. Such products are better regarded as joint products, differing, it is true, in importance, and value as well as nature, but nevertheless meriting equal consideration as products. [442]

Q. Would you agree with that?

Mr. Bennett: I suppose counsel in line with previous questions is reading or purporting to read from some article that somebody has written. According to my remembrance, it is never proper to cross-examine a witness about some authority, something someone else has said unless it is shown that the witness has based his opinion upon what the author has said. I think that principle has been well established in the rules of evidence and requires no citations. If Your Honor wishes citations, I will supply them.

The Court: What is it you are reading from?

Mr. Rosenberg: At this point, Your Honor, I will say it is an extract from an authority and I concede when and if I use the authority as for the purpose of impeachment, I am obligated to disclose the authority. There is no question about that, but I think I am entitled to ask this witness

(Testimony of C. Bruce Flick.)

as an expert whether he agrees with this as a statement. If I have any authority from which I have derived this and I desire to use it as a means of impeachment, certainly I must disclose the authority, but I submit at this point I am under no obligation in putting this as an abstract question and asking this expert if he agrees with that as a correct statement, a correct statement of that proposition.

Mr. Bennett: Your Honor, I think there is a further objection. If I still carry in mind what was read, he is trying [443] to get by an entirely different factual situation than here. In his hypothetical situation he is dealing with a product where counsel or the author states that by reason of certain physical facts the so-called different product, byproduct, may be a co-or principal product and that it may be treated as a byproduct. There is nothing in the evidence so far that this calcium sulphate which is the impurity removed from the bittern water to make possible the production of the primary product defined in the contract, that the evidence also shows that it would be a valueless waste unless there were something done to it, that was a declaration by the defendant's executive vice president.

The Court: Read the question.

(Question read.)

Mr. Rosenberg: That is an abstract question which I am asking an expert to state whether or not he agrees with.

(Testimony of C. Bruce Flick.)

The Court: Overruled.

A. No, I don't agree with it.

Mr. Rosenberg: You would not agree with it.

Q. Mr. Flick, you know this book, the official publication of the National Association of Cost Accountants, do you? A. No, I do not.

Q. This may have been reprinted somewhere, but this appears as in Volume 1, No. 1, under date of August, 1920, and it is National Association of Cost Accountants' official publication. [444]

A. 1920.

Q. Yes, and the article is entitled "Accounting for Byproducts." Have you ever read that article?

A. No, I have not. That was published 27 years ago.

Q. Yes.

Mr. Bennett: Counsel, are you going to cross-examine the witness or attempt to impeach the witness by anything that is written or said there?

Mr. Rosenberg: I think I will ask him if he agrees or disagrees——

Mr. Bennett: I think before you even proceed I should object. I am entitled to object. I previously stated the rule, if Your Honor please, that the witness has not been shown to have based his opinion on any document, report, so-called authority, textbook or the like; where that is so he may not be cross-examined with reference to what may be contained or said in any such book or document or text because it is improper cross-examination and for the further reason that it is an

(Testimony of C. Bruce Flick.)

indirect and improper way of getting before the Court improper evidence.

The Court: Nothing before the Court, gentlemen.

Mr. Bennett: The reason I made the objection, I wanted to object before cross-examination started, before counsel started to read or comment upon specific excerpts, if any, from this particular document; that has nothing to do with the witness' [445] testimony to date.

Mr. Rosenberg: Let me ask you, Mr. Flick, if you would disagree with this statement that is contained in this article to which I direct your attention.

Mr. Bennett: If Your Honor please, I make the same objection, not proper cross-examination; no proper foundation has been laid; it is improper, irrelevant and immaterial.

The Court: In what respect has not the foundation been laid?

Mr. Bennett: Well, it has been definitely shown, Your Honor, that the witness has not read this book, that his testimony is not based upon anything that is said in the book.

The Court: You will concede he is an expert?

Mr. Bennett: Yes, yes, Your Honor, very definitely.

The Court: I will allow the question.

Q. (By Mr. Rosenberg): Will you agree with this statement to which I direct your attention: "Many byproducts, however, rank nearly as high in

(Testimony of C. Bruce Flick.)

importance as the main products. This is true, for example, in the packing and coal and oil and chemical industries." Would you agree with that?

A. "Many byproducts rank nearly as high in importance as the main products." I suppose that is true.

Q. It is true in the chemical——

A. I don't know that it is true in any particular industry. It might be in any particular situation. [446]

Q. Would you agree with this statement——

Mr. Bennett: May my objection go——

The Court: It will go to all this line of testimony.

Mr. Bennett: So that I am not deficient in my duty as counsel to move to strike the answers of the witness before and any other answer that is responsive to these questions upon the same ground that I urged the objection.

The Court: Very well.

Mr. Bennett: The objections and the motions to all questions and answers of this character.

The Court: Let the record so show.

Q. (By Mr. Rosenberg): Would you agree with this statement: "It is difficult to lay down any hard and fast rules for byproduct accounting which can be generally followed because each plant has individual peculiarities to be considered. The same method of accounting will not be acceptable for two plants in the same industry for the rea-

(Testimony of C. Bruce Flick.)

son the product may not be processed in the same way.”

Would you agree with that?

A. I think that I will agree to this extent, where you differentiate, as that statement does, to say that in two different plants the product may not be processed in the same way, you may have a distinction between whether it is actually a by-product or not, but there are certain general principles of accounting applicable to byproducts as distinguished from joint [447] products or main products or co-products.

Q. I would like to read this again, where the author says, “It is difficult to lay down any hard and fast rules for byproduct accounting.” He is talking there of byproduct accounting?

A. Yes, but read the rest of the sentence.

Q. “Which can be generally followed because each plant has individual peculiarities to be considered. The same methods of accounting may not be suitable for two plants in the same industry for the reason the product may not be processed in the same way.”

A. Well, “hard and fast rules.” In accounting it is true that there are no hard and fast rules in the sense that accountants can look in a rule book and find the answer without considering the proper circumstances, if I make myself clear on that. There are generally accepted accounting principles applicable to byproducts. Now, the accountant as an accountant in any particular plant knows

(Testimony of C. Bruce Flick.)

what the facts of production are in order to decide whether those principles are applicable. For example, in this case it is clear that they are applicable carried to this byproduct gypsum.

Q. What are applicable to byproduct gypsum?

A. These principles of accounting for byproducts.

Q. Do you concede there is only one accepted method recognized by accounting authorities for the accounting for a byproduct? [448]

A. I don't know what you mean when you say one accepted authority. There are several principles which are applicable to accounting for the cost of production of a byproduct. We have covered those pretty well here.

Q. That is what I mean. Is it your opinion there is uniformity of opinion between accountants as to the accounting to be employed in byproduct accounting?

A. There are generally accepted principles of byproduct accounting.

Q. One of the principles is the one you mentioned, that no overhead or indirect costs are to be included.

A. One of the principles is this, that you don't charge anything to a byproduct prior to the period of separation. The next principle——

Q. Well, let's stop there.

Mr. Bennett: Let him finish.

Mr. Rosenberg: All right.

The Witness: The next principle is, that is this one, the one you just referred to. The next prin-

(Testimony of C. Bruce Flick.)

ciple is that you charge to the cost of production of the byproduct the actual charge. out of pocket expense which you are put to because you elect to process the byproduct material so to give it some value rather than simply dump it as a waste. Now, the cost of producing the byproduct, those costs are any expenses which are out of pocket due to your processing it, but they do not [449] include any indirect or overhead expenses which you would have anyway if you quit making the byproduct or if you dumped the byproduct material into the Bay, or overhead which you would have anyway or which you might have in a lesser but unascertainable amount.

Q. You believe that there is uniformity among accounting authorities as to those principles which you just announced, do you?

Mr. Bennett: I object to that as argumentative and not proper cross-examination, whether there is uniformity of all authorities or not. Well, I will withdraw the objection.

The Witness: I will say it is the other——

The Court: Did you withdraw your question?

Mr. Rosenberg: No.

Mr. Bennett: I withdrew my objection.

The Court: You may answer.

The Witness: The question is whether I think there is uniformity among accounting authorities as to byproduct accounting principles?

Mr. Rosenberg: As you have stated.

A. I think that it is quite obvious that there is not absolute uniformity because we have here

(Testimony of C. Bruce Flick.)

a case of Westvaco which ignores the byproduct character of the gypsum in its cost and then under their own accounting system which I have been told was approved by Peat, Marwick & Mitchell, elects to treat the [450] byproduct as if it were a joint product.

Q. Have you ever heard of that being done?

A. I heard of it in the case of Westvaco.

Q. And nowhere else?

A. I don't know of any other case.

Q. Now, I will direct your attention to here at page 7; the author has a heading, "General Methods of Accounting for Byproducts," and says:

"Three general methods of accounting for by-products are discussed in this publication. They may be designated respectively as (1) no costs; (2) preparation for sale, selling and administrative cost; and (3) total cost."

Mr. Bennett: Your Honor, before counsel reads further and to avoid the indirect and improper way of getting before Your Honor and going into improper lines where somebody, some person unidentified, he is not under oath, we don't know what his qualifications are, makes some statement, obviously it is improper for the defendant to inject something like this before Your Honor without any facts and without any foundation, it is to avoid the situation of getting before the Court all evidence that should come before the Court and getting in something——

The Court: If I followed the testimony, the witness on the stand indicated that this book was

(Testimony of C. Bruce Flick.)

27 years old. He is familiar with the book. [451]

Mr. Bennett: He says he has never seen it, he has never read it.

The Court: He does not need to see it.

Mr. Bennett: Never heard of it before.

The Court: He does not need to. He is an expert witness. He is seeking to frame a question and ask if he agrees with that principle. The witness on the stand is an expert.

Mr. Bennett: I understand that. The reason I mention as a basis for my objection—it is the rule that is always applied by the Court when the expert is examined——

The Court: I agree with you.

Mr. Bennett: Counsel has not done as he should do. I am just asking in the light of it that he lay the foundation. Now he takes this book and attempts to show to Your Honor this is something written by somebody who knew all about it and this is what he says—it is the vice of getting before the Court unsworn testimony, testimony that is not identified.

The Court: Well, usually courts do not make the admission that I am about to make. I need all the information that I can get on this field of expert testimony in relation to accounting and it was because of that reason that I indicated at the outset I allow the widest latitude that I can within the rules. The only comfort you can get from it is that we are developing a record here.

Mr. Bennett: I am trying to develop the record

(Testimony of C. Bruce Flick.)

for Your [452] Honor's benefit rather than the record's.

The Court: I have had these problems here and as far as I have gone, I cannot see any abuse. The very crux of this case, the very heart of it is now being developed. For that reason I am liberal in allowing the testimony.

Mr. Bennett: We are going to produce to Your Honor some additional experts on this question.

The Court: He asked if he agreed with a statement.

Mr. Bennett: I know, but what he is doing is to impart to Your Honor that he is reading some authoritative work.

The Court: That we have already developed. It is 27 years old. It may be of some value. [453]

Q. (By Mr. Rosenberg): Mr. Bennett said the author of the work does not appear. May I direct your attention, Mr. Flick, to the fact that it is stated here, "This publication has been prepared by the research department of the Association," which is the National Association of Cost Accountants, "from information received in reply to a questionnaire sent to certain members of the Association on the subject of accounting for byproducts, and from other material in the possession of the research department."

That is a common type of publication for the National Association of Cost Accountants to issue, isn't it?

Mr. Bennett: If Your Honor please, I object.

(Testimony of C. Bruce Flick.)

Mr. Rosenberg: All right. I will withdraw it.

Mr. Bennett: I understand my objections and motions to strike run through the course of this testimony without repetition.

The Court: All through this testimony.

Q. (By Mr. Rosenberg): I just call your attention to the fact that this publication speaks of three methods of accounting for byproducts, and the author states: "The first method of byproduct accounting, which probably is used more than any other, is to record only the sales and sales returns of byproducts. One general account or a separate account for each byproduct may be kept, depending on the variety of byproducts sold, and the extent to which the management wishes to go in obtaining [454] data for analysis. The excessive sales over sales returns—that is, the net sales—is usually closed into the current profit and loss account and entered in the 'other income' or 'miscellaneous income' section of the profit and loss statement instead of being treated as a reduction of 'manufacturing costs.' This method may therefore be called the 'no cost' method because the manufacturing costs, and the selling and administrative expenses of the byproducts are not separated from the costs and expenses of the main products."

Now, that is one of the methods of byproduct accounting that you mentioned, is it, Mr. Flick, where you merely credit the net return from the sale of your byproduct and use it as a reduction of cost of production or your main product, is that right?

(Testimony of C. Bruce Flick.)

A. Yes, I mentioned that particularly in connection with a type of byproduct which did not require processing.

Q. Yes.

A. Where you have something in the way of a byproduct material which you could sell without having to process it.

Q. Let me ask if you ever heard of this second method of byproduct accounting:

“The second method of accounting for byproducts differ from the first in that it records the cost of making byproducts salable after they have split off from the main product, the expenses of selling them and the portion of administrative [455] expenses applicable to them. The advantage of the second method over the first is that it gives more information, but neither the first nor the second method indicates the manufacturing costs of the byproducts prior to the time they separate from the main products.”

Is that in effect the method that you have been advocating, that is, only charging direct costs after the time that the so-called byproduct has been separated from the main product?

A. Yes. This, however, mentions expense of selling and the portion of the administrative expense. In all of my testimony we have been talking only about the cost of production of the byproduct or the cost of manufacture of the byproduct.

Mr. Bennett: May I add, Your Honor, as a further basis for my objection, which is the contract

(Testimony of C. Bruce Flick.)

provision. It is apparent from what counsel has read from this book that that had to do with accounting involving selling costs and other things.

The Court: I realize that we are limited to this contract. There is no sales department entering into our problem.

Q. (By Mr. Rosenberg): Let me ask you if you ever heard of a third method that is discussed in this volume:

“The chief feature of the third method of by-product accounting is that it separates the costs of byproducts from the costs of main products, from the very first manufacturing step. Under the first two methods, the costs of main products [456] and byproducts are combined until the point of physical separation is reached. In many cases, however, it is difficult to calculate precisely the costs of byproducts prior to physical separation and consequently, even under the third method, arbitrary initial cost values must often be assigned to byproducts. In some cases these values are regarded as only the ‘material cost of byproducts.’ They may, however, be the manufacturing costs if the byproducts require no further treatment before sale. Under the third method, perpetual inventories of byproducts are kept, which will show quantities and values. The method should not be adopted unless it will be practicable. This depends upon the degree of accuracy which can be attained without needless ‘hair-splitting’ over details, and

(Testimony of C. Bruce Flick.)

upon the relative value of the byproducts in comparison with that of the main product.”

If I understood your testimony before, you had never heard of any accepted accounting practice where anything was charged to the byproduct prior to the point of separation, is that right?

A. I do not know whether I said I never heard of it. I think I said it is recognized good accounting practice not to charge to the cost of production of the byproduct anything prior to the point of separation.

Q. Will you concede that there are at least authorities who contend that the cost of manufacturing the byproduct should [457] include the costs prior to the point of separation?

A. No. I have never found any such authorities.

Q. Let me read you the summary of the third method which we have just read.

A. May I say I do not regard any book written 27 years ago as an authority under today's conditions and all that has happened in the interim.

Q. Do you have anything more current that you can recommend?

A. At the moment I told you I am not prepared to give you citations.

Q. Do you recall reading anything currently that is to the contrary?

A. I told you I am not prepared to give you citations at the moment.

Q. Wouldn't you recognize this as being pretty good authority until you find something better?

(Testimony of C. Bruce Flick.)

A. No, sir, that is not my way of taking authorities.

Q. All right. Let us read what the research department of the National Association of Cost Accountants has to say under the heading of "Summary of the Third Method," to which I just referred:

"Under the third method byproducts generally are charged (1) material, at an arbitrary value if necessary; (2) labor expended on the byproduct after it separates from the main product; (3) an equitable proportion of overhead, and (4) a [458] proper share of selling and administrative expense, when these items are applied to the various products or classes of products on the basis of manufacturing costs."

Would you disagree with that method of accounting?

A. I very definitely disagree, and when they use terms like "you must" or "assign arbitrary values, if necessary," I do not think you can assume that those words apply to circumstances such as we have been concerned with.

Q. Would you disagree with the author's conclusion:

"On the whole, however, the third method is more logical and it gives information which is of vital importance in the administrative control of the business. A majority of the members of the Association who expressed their views on this matter stated their preference for the third method."

(Testimony of C. Bruce Flick.)

Would you disagree that a majority of the accountants, at least at that time, agreed that the third method that is referred to in that work was the preferable and better—

Mr. Bennett: Just a moment.

Mr. Rosenberg: May I finish my question?

Mr. Bennett: I thought you were through.

Q. (By Mr. Rosenberg, continuing): —is the preferable and better method for cost accounting for byproducts?

Mr. Bennett: Just a moment. Again, Your Honor understands that my objection to the previous questions of similar nature run to this whole line. I think I should add the further objection [459] here that he is asking this witness whether he agrees that the majority of accountants agreed to some statement. How can this witness know that and how is it fair to get before this Court that the majority of this board or whatever it was, said something? There is no proper foundation for that evidence being presented to the Court.

Mr. Rosenberg: I will withdraw that and ask the witness whether, in the light of what you have read, you will agree that there are many reputable cost accountants who are of the opinion it is good accounting practice for a byproduct to include overhead expense.

Mr. Bennett: Same objection that I have given before, and it is improper cross-examination, incompetent, irrelevant and immaterial.

The Court: The objection is overruled. You may answer.

(Testimony of C. Bruce Flick.)

A. When you ask me if there are many cost accountants, all I can say is that the concepts of good and generally accepted accounting principles for byproduct accounting, which I have been trying to explain here on the stand, are those which I understand to be generally accepted as good practice. You can always find people who may do something which is not in accordance with such generally accepted practice. I cannot say whether you may find some cost accountants who vary, but the general principles and application that I have been trying to outline here have been what I understand to be generally [460] accepted good accounting practice for byproduct cost accounting.

Q. (By Mr. Rosenberg): But you can't recall anything by way of treatise, text or otherwise that you have read in which it has been stated that where you are determining the cost of a byproduct that requires processing, in order to make it a commercial product, it is improper to include overhead expense, is that right?

A. It is improper to——

Q. Wait. I say, can you recall any treatise or text writer who has so stated?

A. I told you before, Mr. Rosenberg, I am not prepared to give you specific citations today. That page you showed me on that third method, you will read objections to it. My eye caught the phrase "objections to the third method," which you did not read.

(Testimony of C. Bruce Flick.)

Q. I am not contending, Mr. Flick,—don't misunderstand me—that there is uniformity among accountants as to how byproduct accounting is to be handled. On the other hand, I very definitely contend that it is a very complex subject, as to which there is not the uniformity of opinion that you seem to imply. Now, what was it you wanted to point out here (handing the book referred to to the witness)?

A. "The following objections have been made to this third method. It is difficult in many cases to determine the cost of the byproduct even approximately," that is to say, by the [461] use of that third method.

Q. Let us read the full statement that the author made before stating the conclusion.

Mr. Bennett: I object to that upon all the grounds on which I objected before. Call a witness. Let him be sworn, and let me cross-examine him and not get in unsworn testimony.

Mr. Rosenberg: All right. I withdraw that.

Q. Mr. Flick, you testified in January, 1944, I believe it was, that you had this conference for the purpose of checking this price increase at that time. Among other things you stated that in looking at the files when you first came to the company you found this letter, I believe it is of October 2, 1941, and some other things in Mr. Canvin's files, and among other things you mentioned that letter from Mr. Barrows under date of June 5, 1946, and

(Testimony of C. Bruce Flick.)

will you tell me whether or not any of the conclusions that you arrived at were in any wise influenced by the reading of that letter?

Mr. Bennett: You mean now, counsel, is the conclusion——

Mr. Rosenberg: As to what items are and are not properly to be included in cost of production of gypsum.

Mr. Bennett: Counsel, I think the witness is entitled to this. The witness has testified to two things here: One, the position he has taken with reference to the contract in question, the reasons why he has objected to the items or many of the items, these indirect charges generally that have been [462] charged or sought to be charged by your client against the cost of production of gypsum; he has also testified here as an expert as to his opinion as to what, in accordance with good accounting practice, the term "cost of production" and "actual increase or advance in cost of manufacture of the byproduct gypsum" means. Now, in which category of the testimony of the witness do you direct your question?

Mr. Rosenberg: I am directing my question to the fact that out of, I believe, a 78 per cent increase he decided that we were entitled to 29 cents and we were not entitled to 49 cents, and I want to know whether or not in arriving at that conclusion he was influenced in any degree whatever by the Barrows letter.

(Testimony of C. Bruce Flick.)

The Court: In the interest of time, he may answer. The objection is overruled.

(Question read.)

A. After I made my first examination in January, 1944, I learned for the first time what accounts Westvaco had on their books and what they were charging against the cost of production of this byproduct gypsum. Prior to that time I had only the information which has been referred to in the files, and the previous information showed only these direct items of labor, fuel, power, whatever they were. When I went down there in January of 1944 and found what they were charging to the cost of production, I took the position particularly, based upon my [463] understanding of good accounting practice and how a good accountant would define that term, "cost of production," I took the position that the direct charges, which had increased 29 cents for 1943 over 1942, were proper and that the price should be increased 29 cents on that account. I took the position, based upon my understanding of good accounting applicable here, that these allocations and indirect charges, which would have gone on anyway, even if the byproduct had been pumped into the Bay, were not properly chargeable. There has never been, in other words,— I have never made any attempt to try to build up, for purposes of this contract, anything which was incompatible and in which I personally did not believe as a good accountant.

Q. (By Mr. Rosenberg): Do I understand from that answer that you were or were not influenced

(Testimony of C. Bruce Flick.)

in any degree by the Barrows letter? Were you or were you not?

A. I was influenced, as I have said, by what I considered to be proper accounting under the circumstances and under the contract.

Q. So that the Barrows letter had nothing to do with your expert opinion in that respect, is that true?

A. Now, wait. It had nothing to do with my expert opinion. It had nothing whatever to do with my forming my opinion as an accountant.

Q. You have testified in a number of instances that during the [464] course of the conversations that you had with Mr. Williams and Mr. Wallace that you expressed your willingness and desire to comply with the contract and to try to work the thing out so as to avoid controversy, and it is true also both Mr. Williams and Mr. Wallace expressed the same attitude, isn't that right?

A. They have always expressed the same attitude but they always refused to arbitrate.

Mr. Rosenberg: I think that is all, Your Honor.

The Court: We will take a recess.

(Recess.)

Mr. Bennett: Your Honor, ordinarily I would with the redirect examination of Mr. Flick, but we have an expert witness here, the certified public accountant, who has certain engagements tomorrow that will prevent him from being here and I wonder if I might suspend temporarily the redirect examination of Mr. Flick and put this witness on out of order?

Mr. Rosenberg: I have no objection.

Mr. Bennett: Mr. Webster, will you take the stand, please?

PAUL K. WEBSTER

called as a witness on behalf of the plaintiff, and being first duly sworn, testified as follows:

Q. (By the Clerk): Will you state your name?

A. Paul K. Webster. [465]

Direct Examination

By Mr. Bennett:

Q. Where do you reside, Mr. Webster?

A. San Mateo, California.

Q. What is your business or occupation?

A. I am a member of the firm of Haskins & Sells, certified public accountants.

Q. That firm has an office in San Francisco?

A. Yes, an office in San Francisco and a number of others located throughout the country and in foreign countries.

Q. It might be said, then, to be a national or international firm of certified public accountants?

A. That is correct.

Q. Are you a certified public accountant?

A. Yes, sir.

Q. How long have you been such, Mr. Webster?

A. Nearly 20 years.

Q. Will you just briefly state to His Honor your preparation, training and experience in the field of accounting?

A. I have been associated with the firm of Haskins & Sells for somewhat more than 20 years. I

(Testimony of Paul K. Webster.)

have been a member of the firm for seven years, during which time I have been engaged in the execution of audit engagements, and more recently in the supervision of audit engagements, the development of programs relating to audit engagements, general consultation with clients relating to accounting practices and preparation and [466] review of tax returns and that sort of thing.

I am a graduate of the University of Southern California and spent some time as an instructor of accounting at that institution, and more recently have conducted classes in auditing in accounting subjects to a minor extent at the Extension Division of the University of California and at Golden Gate College in San Francisco.

I have had some experience in general book-keeping and accounting matters prior to entering the public accounting field, but for the past 21 or more years have been engaged exclusively in the practice of public accounting.

Your accounting experience has embraced a field, has it, of determining the proper methods and technique of determining cost of production of products, manufactured products?

A. Yes, my experience has been rather wide in that it covers industrial accounting in a number of industries as well as other types of accounting, such as utilities and financial institutions.

Q. Have you considered from time to time the proper technique to be employed in the cost ac-

(Testimony of Paul K. Webster.)

counting or the determination of cost of production or the cost of manufacture of byproducts?

A. Yes, sir.

Q. State to the Court, Mr. Webster, whether there is a difference, from the viewpoint of the accounting profession, the understanding and practice of that profession, between the [467] cost of production or the cost of manufacture of a main co-product, on the one hand, and a byproduct on the other?

A. Well, of course, various manufacturing processes result in various types of products and byproducts. In many cases there may be no byproducts whatever from a manufacturing operation, in which case obviously all costs are allocated to the main product, or if more than one product, more than one primary product is produced, the cost would be divided between the various joint products or co-products.

In other cases you may have byproducts which are produced as an incident to the manufacture of the primary product, and which perhaps may be salable at the point of separation without further processing. As, for example, the sawdust from a saw mill. The ordinary method of accounting for such a byproduct is that it is credited against the cost of production of the main product, although at times it may be credited to miscellaneous income. But there is rarely an occasion to determine the cost of such a byproduct.

(Testimony of Paul K. Webster.)

With regard to byproducts which are separated from the main product or from the product in process and which require further processing before they are salable, you may or may not determine the cost. In other words, you may without segregation determine the cost of the total process and still credit against that total process the proceeds from the sale of the byproduct. However, it is not unusual to determine the separate [468] cost of processing such a byproduct, and in such a case the ordinary method of determining the cost of the byproduct is to ascertain the amount of the costs which are directly and solely attributable to the manufacture of that byproduct and which are identifiable as such.

Q. When you say "identifiable as such," does that mean ascertainable as such?

A. Yes, substantially that, I should say. In other words, you attempt to determine the amount of the costs which you incur because of the production of that byproduct and which you would not incur if you did not produce the byproduct, and which you would presumably eliminate if you suspended the production of the byproduct.

Q. That is the general principle that, according to your understanding of your profession and accounting principles, would be good and proper practice?

A. That is correct.

Q. In the case of a situation where not only the manufacturer is concerned with, let us say, his cost of manufacture or the cost of production of

(Testimony of Paul K. Webster.)

a byproduct, but also in a situation where the purchaser of the byproduct, the product which requires and receives further processing to make it salable, such as where the purchaser's price for the product would be affected or increased by any actual increase or actual advance in the cost of production or cost of manufacture of the [469] byproduct, what would you say good accounting practice would be with reference to items of cost to be included in the cost of manufacture of such a byproduct?

Mr. Rosenberg: Just a moment. You are not relating that to any particular contract, are you, Mr. Bennett?

Mr. Bennett: I think I am entitled to state such a hypothetical situation, namely, the proper principles of accounting to be applicable not only in the case of manufacturing point of view but where the principles to be applied concerned a purchaser. The reason I make that point, Your Honor, it must be obvious that it might be conceivably not completely or absurdly bad practice for a manufacturer, if he wanted to determine, as against sales of the byproduct, the total cost of production, including the manufacturing, sales and other factors that might enter into it, to adopt certain procedures. But where we are concerned with a practice of accounting, the purpose of which is to determine the actual advance in costs of manufacture, may be—I haven't the witness' answer—that may be a different situation.

(Testimony of Paul K. Webster.)

The Court: Your question is rather involved. I would suggest that you reframe your question so I may follow the testimony.

Q. (By Mr. Bennett): Where the purpose of the accounting method is to determine the actual cost of production or the actual cost of manufacture of a byproduct where some other [470] person or concern, other than the manufacturer, would be affected by that cost of manufacture or cost of production, what would be, according to proper accounting principles, the items of cost that would be included in the cost of production or cost of manufacture.

Mr. Rosenberg: I submit, if the Court please if any accounting practices other than good and accepted accounting practices are to be followed by reason of a contract between the buyer and the seller, it could only be by virtue of what the contract contemplates and provides, and therefore for this witness to answer that question would require him in effect to state what the contractual arrangement was between the parties. Now, I understand this is purely objective.

Mr. Bennett: It is. I have stated a hypothetical case, Your Honor, and I think it is fairly proper to ask this witness. There may or may not be a rule applicable where only the manufacturer is concerned, but according to good accounting practices there may be a different rule applicable. I do not say that there is, but there may be greater reasons, for example, for that rule to be applicable

(Testimony of Paul K. Webster.)

where it is a matter of concern not only to the manufacturer but a matter of concern to the seller. We are dealing, mind you, not with the decision of this case but with this expert witness' opinion.

Q. (By the Court): May I ask you a question for my own information? When you speak of the cost of manufacture and speak of [471] the cost of production, what distinction would you make?

A. Practically none.

Mr. Bennett: I do not contend that there is any distinction.

The Court: That has been used and used repeatedly and I did not think there was any, so I wanted to clear it up. It is only for my own information.

Mr. Bennett: The reason I used that is that paragraph 6 at one point speaks of cost of production and in another place cost of manufacture.

The Court: I wanted to know if there was any distinction.

The Witness: I would say not.

The Court: Proceed.

Mr. Rosenberg: I will object to the question, if the Court please, on the ground it is incompetent, irrelevant and immaterial and unintelligible——

The Court: I am prepared to rule on the question. I think it is well to break it down. It is involved, and so I may follow the testimony definitely, I suggest that you reframe your question.

(Testimony of Paul K. Webster.)

Mr. Bennett: I will approach it in a different way, Your Honor.

Q. You stated, as I understand it, Mr. Webster, in determining the cost of production or the cost of manufacture of the byproduct, that type of byproduct that does not require any [472] further processing but has some value as soon as it is separated from the process of manufacturing the main product, the usual or common practice is simply to credit the proceeds from the sale of that byproduct against the cost of manufacture of the main product; in other words, from an accounting point of view, not to determine that there are any actual costs of manufacture of that type of a byproduct.

A. That is correct.

Q. On the other hand, the type of byproduct that requires after its separation in the process of manufacturing the main product or the primary product some further processing, such as the example of sawdust, the manufacture of sawdust into these Presto-O logs or little molded forms that are used for firewood, that in determining the cost of manufacture or the cost of production of that type of byproduct, only those costs which are directly and solely required or incurred in the manufacture of that byproduct from the point of separation and which are identifiable or ascertainable as such are used, is that correct?

The Court: Answer for the purpose of the record.

A. Yes, that is correct.

(Testimony of Paul K. Webster.)

Mr. Rosenberg: If you are undertaking to state the witness' testimony, I think the witness testified, Mr. Bennett, that in the case of a byproduct of that kind which requires further processing, you either may or may not determine its cost [473] of production.

Q. Isn't that what you said, Mr. Webster?

A. Yes, that is correct. You may or may not.

Q. (By Mr. Bennett): If you do not, you treat it just as you treat the other type of byproduct that is salable without further processing, is that correct? A. That is right.

Q. And in that case there would be no cost of production assessed against that?

A. That is correct.

Q. The other alternative, where you actually set up or seek to determine the cost of production, you consider what items of cost?

A. Those items which are directly applicable to the production of the byproduct and which would not be incurred if you did not produce the byproduct.

Q. You said something about also being ascertainable.

A. That is correct. Obviously from a practical standpoint you are trying to fix costs for the byproduct which can be determined with a degree of accuracy based on ordinary accounting methods.

Q. You would not include, as I understand it, items that are not directly ascertainable in both

(Testimony of Paul K. Webster.)

character and amount as being necessary for the production of that byproduct?

A. That is correct. [474]

Q. Can you be, to the aid of the Court, more specific, Mr. Webster, by example or illustration, if that is possible, of the type of costs that would be included in the cost of the production or manufacture of the byproduct?

A. Do you wish me to assume a certain type of byproduct or just any one?

Q. Let us start off with that situation we gave about the Prest-O logs, for example. I will withdraw that situation. Let us say, rather, the manufacturer has a plant where the purpose is to manufacture a primary product which we call magnesium oxide. This product is manufactured from a substance known as bittern water, which substance is sea water condensed by processes of evaporation and other processes, and after the salt is removed therefrom by, let us say, a salt company, the bittern water or the remainder after the salt is taken from it is purchased by this manufacturer and to this bittern water is added a chemical product known as calcium chloride, the effect of which is to form in bittern solution a chemical combination known as magnesium chloride, which chemical combination, magnesium chloride, is further processed by the addition of other chemicals, such as calcium hydroxide, and from that manufactured the primary product, magnesium oxide.

(Testimony of Paul K. Webster.)

But in that step of manufacture, after the addition of the calcium chloride to the bittern water, there is precipitated a chemical known as calcium sulphate. The process for the [475] manufacture of the primary product, magnesium oxide, requires the removal from the magnesium in the bittern water of the sulphate, which is also present in chemical form, and the calcium sulphate, which is precipitated in the process of manufacture, is necessary to be removed, in order to manufacture or to produce the primary product, magnesium oxide, but which product, calcium sulphate, at its point of separation from this fluid, which goes on for further processing in order to manufacture the primary product, requires drying, grinding and delivery to railroad cars in order to make it salable. Now, also on the assumption that that calcium sulphate, dried and ground, is known as gypsum and is also a byproduct—on these assumptions what would be the items that would be included, according to good accounting principles and according to your experience and opinion as to the cost or costs of production or manufacture of the byproduct gypsum.

A. I assume now for the purpose of this answer that the gypsum or the material which is withdrawn is in effect an impurity for purposes of the main product and would, without further processing, be valueless or substantially valueless at the point of separation. Consequently the problem is to determine the cost of putting that in salable form as

(Testimony of Paul K. Webster.)

against discarding it or throwing it away. Now, on the basis of those assumptions it seems to me that accepted accounting principles would require that for the purpose of determining the cost of the by-product [476] gypsum——

Q. The cost of production.

A. The cost of production of the byproduct gypsum, you ascertain the costs which are incurred solely because of the production of that gypsum as against the throwing away of the gypsum or of the product from which the gypsum is made. Now, those costs would obviously be labor in drying and grinding the product, in fuel or water or power that was used in the process, that is, the process related to the gypsum; other costs which are directly applicable, presumably including repairs to that machinery that is used in connection with the gypsum, reasonable allowance for depreciation of that machinery, possibly taxes and insurance on that part of the plant that was devoted to gypsum and any other costs which could be shown to be necessary to the production of gypsum and not necessary if gypsum were not to be produced. I might add that obviously a determination of that sort would be highly desirable not only from an accounting standpoint but also from a management standpoint in determining whether the gypsum should be processed and sold or whether it should be discarded. Obviously if it were to cost more to process it and to prepare it for sale and the principal

(Testimony of Paul K. Webster.)

proceeds, the obvious management decision would be to discard it rather than to process it. [477]

Q. State whether in the situation given you in direct charges which would have been incurred if no gypsum had been produced, that is processed by drying, grinding and delivery but in lesser and unascertainable amounts, would any of such costs or indirect charges of that character be properly included in the cost of production or manufacture of gypsum.

A. The question in my mind is not whether a charge is direct or indirect. The question is whether or not it is attributable solely to the production of the byproduct and whether the amount attributable to the production of the byproduct can be ascertained. In other words, what I am trying to say is that the cost considered as a part of the cost of producing the gypsum, in this case, whether they are classified on the books as overhead or direct, it seems to me, is unimportant as long as they are directly attributable to the manufacture of this product.

Now, it also seems to me that in ascertaining a cost of a byproduct only those costs should be included which are ascertainable.

In other words, if there is some type of indirect expense which might be affected to a minor degree by the elimination of the production of gypsum, but the expense of that further can not be measured or ascertained, then from a practical standpoint

(Testimony of Paul K. Webster.)

I would say that that should not be included in the cost of the gypsum.

Q. Would you say that any charges which would have been [478] incurred if no gypsum had been produced but in a lesser and unascertainable amount should be considered as cost of production of gypsum?

A. If I understand your question, I believe the answer would be no, because my point is you should be able to ascertain the amounts applicable to gypsum or else you should not charge it.

Q. Mr. Webster, I am going to hand you here a list of charges and purported costs which are set forth on Exhibit F to the defendant's interrogatories in question here, which is Plaintiff's Exhibit 15, under the title in two columns, the figures are in two columns, one for the period July 1, 1944, to July 30, 1945, and the other column is from July 1, 1945, to June 30, 1946, and I will ask you to go down the items under the subparagraph B of said exhibit F and tell the Court which of those items, in your opinion, are properly includable as cost of production or manufacture of the byproduct gypsum, and in this connection, I would like you to also refer in addition to the item which is listed on the lefthand column of the page with the comment which appears on the righthand column such as the first word "Allocated," underneath that, "Actual Time Card," and so forth.

A. The first item is supervision. I presume that means general supervision of the plant which is

(Testimony of Paul K. Webster.)

stated to be allocated. If the supervision should be—if a separate supervisor were required for the gypsum operation, that would be a proper charge. [479] However, the assumption from this item would seem to be that plant supervision cost and the cost of the plant superintendent would go on regardless of the gypsum produced. If that is the case, no charge should be made to the gypsum operation. If, however, the plant superintendent or others saw fit to keep records of the time devoted to gypsum to have their salary or salaries ascertained and charged on that basis, it would seem to me no objection to that charge if such determination were made.

Q. Pausing a minute, if the gypsum should be discontinued, that is the manufacture of gypsum stopped from this point of separation, and this item of supervision would continue on, even though it would continue in a less degree but an unascertainable degree, should or should it not be included in the cost of manufacture or the cost of production of gypsum?

A. Without further information than is indicated here, I would say the answer would be no.

Q. Take the next item.

A. Labor, operation, actual time card distribution, and it seems to be a direct charge related solely to gypsum operation and would seem to be includable.

Labor repairs, actual time card distribution. The same answer. Materials—operations, storeroom

(Testimony of Paul K. Webster.)

requisitions and direct purchases. Assuming that those are materials used in gypsum operations, they would seem to be a proper charge. [480]

Q. Would that be so if it were merely charged on a so-called allocating basis without—

A. No. The amount which they had—the direct materials used for the operation and accounted for as such. Materials-repairs, same answer if the repairs related to the gypsum operation, it would be entirely acceptable.

Bittern, arbitrary allocation. Well, it would seem to me that the purpose of using bittern as you have described it would be to produce the main product and not the byproduct and I would not be inclined to allocate any of the basic material costs to the byproduct.

The next item, sulphuric acid—

Q. Well, we will come to that and I will ask you a question later.

The Witness: Shall I proceed with the other items?

Q. Yes.

A. The next items, water, power, gas, fuel oil, all of which are stated, or are costs measured, would relate to the production of gypsum so they seem to be properly includable.

The next item is sulphuric acid. Incidentally, I might say in regard to fuel oil, in the early period there is no column in the account, column for the fuel oil and I think it should be brought out that the items included in these two periods should be

(Testimony of Paul K. Webster.)

based on the same method of accounting which may indicate a difference in the type of fuel used, in which [481] case it may be that the fuel oil was used in the earlier period and was not charged and if so, then certainly that should be taken into account in determining whether or not there is an increase in cost.

Q. Well, if fuel oil was used before and not charged against the product and then in the second comparative period it is charged, would that be in accordance with proper accounting practice where the purpose is to determine the relative costs for the two periods?

A. Definitely not. In other words, if you are attempting to ascertain increase or decrease in cost of production, your methods of accounting for the two basic periods under consideration should be the same.

Q. The next item, you say, is sulphuric acid.

A. Yes.

Q. Well, in the first period is there any charge for sulphuric acid?

A. No charge for sulphuric acid in the first one.

Q. The second period, there is a charge?

A. Yes.

Q. Would you say on the basis of your previous answer the same answer would be given?

A. Definitely.

Mr. Rosenberg: Wait, just a minute. I will object because the proper foundation has not been laid. There is [482] evidence in this record that

(Testimony of Paul K. Webster.)

during the prior period and, incidentally, in the hypothetical question that Mr. Bennett asked, he did not even mention the bromine process, and as far as this question is concerned, the evidence shows without contradiction that in the prior period during which there was no charge for sulphuric acid, the bromine towers were operating, in the second period they were not. I believe that should be included or the question would be entirely meaningless.

Mr. Bennett: I think that is something separate and apart. The witness stated in answer to counsel's point, that irrespective of physical factors where the purpose is to compare two periods to determine either increase or decrease, that the same accounting principles or system must apply. In other words, they cannot in the second period where an increase is claimed, add an item that was not contained in the previous period, if I understand the witness' testimony with respect to this so-called bittern.

The Witness: That is correct. It would seem to me that in this case there should be a charge for sulphuric acid in the first period if there is to be one in the second period. However, whether or not there should be one in the second period is another question on which I have not yet expressed a view.

Q. But whether or not there should be a charge in the second period, the period where an increase in cost is claimed, would it be proper to include

(Testimony of Paul K. Webster.)

there an item such as sulphuric [483] acid, which did not appear therein the previous period?

A. It would seem improper to me, based on my limited knowledge of the facts.

Q. Assuming, aside from your answers so far, that this sulphuric acid, is added to the bittern water or the solution from which the primary product, magnesium oxide, is to be produced, but prior to the separation of the calcium sulphate which is precipitated out the bittern in order to make magnesium oxide, the said calcium sulphate being the impurity that must be gotten rid of—

Mr. Rosenberg: You might as well say in—well, I object to that assumption in the question. There is no evidence in the record, as far as I know, that this sulphate is an impurity. Mr. Flick, who admittedly is not a chemist, used that term on a number of occasions, but it was agreed he was not qualified as a chemist.

Mr. Bennett: I thought the *witness* Rosenberg said that in his opening statement, he admitted the process shown on the chart here was substantially correct only it was an oversimplification.

Mr. Rosenberg: That's right.

Mr. Bennett: In other words, he did not correct at that time, Your Honor, that which the chart showed and what I commented upon about this calcium sulphate from which the gypsum is made being an impurity that has to be taken out of this [484] bittern water with the addition of this calcium chloride and we consider this sulphuric acid

(Testimony of Paul K. Webster.)

in order to make the end product, like the peach pit has to be taken from the peach before it can be canned.

Mr. Rosenberg: I never said anything of the kind.

Mr. Bennett: I thought you agreed. Anyway, I think I am entitled to such a hypothetical question even if I have to fill it in.

I will go back again in view of all this discussion and break my question up in two.

Q. Assuming, Mr. Webster, aside from the fact no charge is made for the sulphuric acid in the first of the two comparative periods that in the process of manufacture during the second comparative period that this sulphuric acid was added to the process in manufacture prior to the point of separation of the byproduct and is a step or part in the manufacture of the primary product, and then aside from the objection which you pointed out, is there any other objection or not as to the inclusion of sulphuric acid as a proper item of cost of manufacture or cost of producing the gypsum? A. Yes.

Mr. Rosenberg: Just a moment. I object. It assumes a fact not in evidence, that is that the sulphuric acid is necessary to produce the magnesium oxide. There is no evidence in this record.

Mr. Bennett: Well, I will strike out the part "necessary" or "desired" and ask the witness the same question on the assumption the sulphuric acid

(Testimony of Paul K. Webster.)

is added or employed in the process of manufacture and prior to the separation of the byproduct.

A. Well, if the sulphuric acid is used for the purpose of separating an impurity from the main stream of production and would be used regardless of whether the calcium sulphate were to be saved and sold, then it seems to me that the sulphuric acid is an identifiable part of the cost of the main product and not of the gypsum. However, if the sulphuric acid were added only because you intended to produce calcium sulphate or gypsum, you might conceivably get another answer.

Q. Will you describe the next item?

A. Next item is described as overhead, which is supposed to be allocated on a labor basis. On the basis of that information alone, it would appear nothing would be chargeable to gypsum. However, there may be items in there that would be chargeable to gypsum if they were identified and ascertained.

In other words, as I said before, the question of classification as to overhead on the process described to me on what I will call the hypothetical question, it is a question of whether the items considered to be costs are actually costs incurred——

The Court: Regardless of what they are labeled?

A. That's right. [486]

The Court: Taxes.

A. Taxes, insurance and depreciation, I think we can consider together although they are not entirely similar. Depreciation is includable as far as

(Testimony of Paul K. Webster.)

it affects the gypsum equipment or the gypsum plant. Taxes and insurance would be the same although some question could be raised as to those items. However, I think from a practical standpoint, it would be includable.

Inter-departmental charges at cost. I don't know what those are. I would hesitate to express an opinion without more information. It is a similar item, in any event.

Shipping expense—

Mr. Bennett: We pause a minute to go back to depreciation. Assuming that depreciation should be included, what should be included appropriately as to items of actual cost of manufacture of a by-product, depreciation of what?

A. Depreciation of the facilities which are used specifically for the processing of the gypsum.

Q. Is there any limitation or restriction as to how that depreciation should be determined?

A. Well, I think that is getting into something that is not strictly an accounting problem. There are several methods of determining depreciation. The one to be selected in a case like this would depend to a large degree on the circumstances.

Q. In a case where the purpose of the accountant is to determine increase or decrease in cost of production which would in [487] turn affect the price of the product to the purchaser and the price based upon a per ton factor, would any acceptable method of computation be applicable, or can you

(Testimony of Paul K. Webster.)

state a certain formula for determining the depreciation or rate of depreciation?

A. I should think the depreciation charge should be something in proportion to the production because you may have a situation where production is very low in one year and you get a very high per ton cost. If you have considered a straight line method of depreciation, it might not be a fair cost at all on a unit basis for production of gypsum.

Q. Would you say the so-called straight line basis of depreciation would be applicable in the hypothetical case I have given you?

A. Well, it would seem to be less desirable than a basis which would be in proportion to the production. I might point out here that that does not necessarily imply that the company in its own accounting must have a unit or production basis for depreciation. It is not at all uncommon for a company involved in the sale of a particular product to make separate computations of its costs for the purpose of the contracts which may be entirely different from the cost shown on the books. In other words, one accounting method might work if only the company's interest for their own use were concerned whereas in other instances other principles would be applicable where other parties were [488] affected, especially where there is a contract.

Q. Yes.

A. Shall I proceed with the other items?

Q. Yes. A. Shipping expense.

Q. Wait. What taxes are to be included in cost

(Testimony of Paul K. Webster.)

of production of byproducts? What tax and on what basis should the tax be included?

A. Well, there are several types of taxes that might be included.

The Court: Read that on the left side, 28 cents for actual cost—

The Witness: Actual cost plus pro rate of miscellaneous shipping expense.

The Court: What does that mean?

A. I presume there are some actual shipping expenses relating to gypsum and possibly some overhead expenses of the shipping department that are prorated on the same basis.

Mr. Bennett: I am coming to that point in a moment, Your Honor. I wanted to clear up this matter of the tax situation.

The Court: Pardon me. Proceed.

The Witness: Taxes of several kinds might be applicable here. For example, social security taxes representing the employees in the gypsum department would obviously be a direct [489] cost of the production of gypsum. Property taxes relating to the assets used in the production of gypsum.

Mr. Bennett: You mean by that the actual and only the actual facilities that are used in the processing of this byproduct, the grinding and drying?

A. Yes, that is correct.

Q. You expressed some question as to whether or not taxes should necessarily be included in the cost of production and manufacture of gypsum. Will you state the reason?

(Testimony of Paul K. Webster.)

A. Taxes are something tied up to your general cost of doing business rather than as a cost of a manufacturing process.

Q. In other words, there is a difference between general cost of doing business and in this manufacturing or production of a particular product?

A. Correct, but from a practical standpoint in a case like this if the tax applicable to this, if the property tax applicable to gypsum, if that was readily determinable, I would have no objection to including that.

Q. What would you say with reference to a system or plan of accounting that charged up as cost of production and manufacture on the books as taxes the prorated percentage of the total book assets of an entire plant portions of which were not used—Pardon me. Strike that question.

In connection with the tax situation and this property tax, if that were to be included in the cost of production, [490] would it be proper to allocate as a cost a certain figure which represents the percentage roughly calculated in relation to the value of a whole plant or could some other formula be employed in determining the tax cost or charge for the comparative periods under consideration?

A. Well, I would prefer not to use an allocation in a situation of this kind because it generally would be itself a statement where you have the valuation of the plant involved and apply the tax rate to that and you get an actual figure. How-

(Testimony of Paul K. Webster.)

there might be no serious objection to it. As long as you accomplish substantially the same figure that you have to accomplish and you get an applicable determination for the gypsum——

Q. Any arbitrary or unrelated method of allocating taxes if they are to be included would be improper. A. Yes, I would say so. [491]

Mr. Rosenberg: I object to that on the ground there is no foundation laid for that. Where is there any evidence of any arbitrary allocation of taxes?

Mr. Bennett: Counsel, I am trying to have the witness state his understanding of the proper principal of allocating tax costs that are to be included, and I think I can state hypothetical questions to him.

The Court: There is a differential here of 7 cents with relation to the items mentioned in this last exhibit referred to.

Mr. Bennett: It is not only the items we are objecting to, your Honor, but it is the method by which they are determined. I think we shall not have so much trouble with the items, once we decide and get established in this case what costs are to be allocated.

The Court: If I followed this witness' testimony, it might apply to either one. If I am in error about that, you correct me.

The Witness: Either one of which?

The Court: Methods in relation to taxes on real property.

(Testimony of Paul K. Webster.)

The Witness: Yes, it would be preferable to have a direct determination, but an allocation on a basis that would arrive at substantially the same result might be acceptable.

Mr. Bennett: Yes, Your Honor, but the witness also stated that on an allocable basis it has to bear relation to values, that is, the value of the particular property that is being used for gypsum in its relation to the value of the whole plant. [492]

The Court: I understand that.

Mr. Bennett: There can't be any arbitrary——

The Court: Counsel objects to your using the word “arbitrary,” for there hasn't been any evidence, as he contends, that there has been any arbitrary method used.

Mr. Rosenberg: That is right.

Mr. Bennett: Let me say this, your Honor: In their answers to the interrogatories they say the taxes have been roughly allocated. Now, “roughly allocated” was not what the witness said should be done, as I understood his testimony.

The Court: If you can clear that up in any fashion it is all right with me.

Mr. Rosenberg: The only evidence before the court is what is contained in there. It says it is allocated on the basis of plant value.

The Witness: Roughly based on plain value.

Q. (By Mr. Bennett): Is that rough allocation proper?

A. I think it should be sufficiently accurately done so that you will arrive at substantially the

(Testimony of Paul K. Webster.)

same figure that you would have arrived at had you determined the valuation and the tax rate applicable to that specific equipment.

Q. State whether or not you consider as proper a rough allocation of taxes?

A. Not for the purpose of what we have involved here.

Mr. Bennett: Does that clear the matter up, your Honor, on [493] that point?

The Court: It is as clear now to me as it was in the very beginning.

Mr. Bennett: Then your Honor has a better understanding that I did.

The Court: I will say I have a better understanding of these commonplaces.

Mr. Bennett: I was not criticizing your Honor. That was perhaps a little side remark that I made in all respect to your Honor. Your Honor had really seen the point, perhaps, without my going into it.

The Court: While I have not gotten into the chemical or accounting fields to any degree, I have heard experts for years testifying, and that might be helpful to me in my appraisal of what this testimony spells out. Now, proceed, gentlemen.

The Witness: Shipping expenses is the last item, and shipping expenses, as I would interpret it, might not specifically relate to cost of production, or cost of manufacture.

Q. (By the Court): The contract would probably take care of that, shouldn't it?

(Testimony of Paul K. Webster.)

A. It seems to me it should.

Q. (By Mr. Bennett): Actual, so-called direct shipping expenses would be included or not included in cost of manufacture?

A. Well, as such, hardly in cost of manufacture, although they might be appropriate charges in determining the cost. [494]

Q. They would not strictly be cost of manufacture? A. No.

Q. Assuming, though, that they could be or would be considered cost of manufacture, should there be any shipping expenses charged that are simply allocated but which cannot be ascertained as directly required in the handling of gypsum?

A. No, I think you would apply the same principle there as you would to other indirect items, that you should charge them only to the extent that you can directly associate them with the production or shipping of gypsum.

Q. Assuming that a manufacturer had, according to his own system of accounting, a shipping clerk take care of shipping for the whole concern, the operation of the whole plant, including the primary product produced, and in the event the by-product gypsum was no longer produced, they no longer processed it for sale, and that production of gypsum was shut down, his employment would go on the same way as before, that is, they would have his salary as the shipping clerk: Would any part of his salary, even assuming that shipping ex-

(Testimony of Paul K. Webster.)

penses were a cost of production, be chargeable against the cost of manufacture of gypsum?

A. I would think not.

Q. Take the case of the accounting department, where they have, say, two clerks or three clerks handling all the accounting detail, sales invoices, all of the records that went on, the general accounting for the plant, and in the event the by-product [495] was no longer produced, or its production stopped, that accounting department would still go on, even though the work would be to a less degree by reason of the stoppage of manufacture of gypsum, but in an ascertainable degree: Would it be proper to allocate any portion of that accounting office or charges to the cost of manufacture of gypsum? A. I would say no.

Mr. Bennett: You may take the witness.

The Court: It is time for adjournment.

(Thereupon an adjournment was taken until tomorrow, Wednesday, December 17, 1947, at ten o'clock a.m.) [496]

Wednesday, December 17, 1947, 10 o'clock a. m.

The Clerk: Pacific Portland Cement Company vs. Westvaco.

PAUL K. WEBSTER,
resumed the stand.

The Court: You may proceed now, Counsel.

Cross-Examination

Q. (Mr. Rosenberg): Mr. Webster, have you

(Testimony of Paul K. Webster.)

ever visited the plant at the Westvaco Chlorine Products Company at Newark, California?

A. No, I have not.

Q. So the only knowledge that you have of the operation at the plant is what you have gleaned from the questions that have been put to you by Mr. Bennett, is that it?

A. That is correct.

Q. And the assumptions that he asked you to indulge in in the questions that he put to you, is that it?

A. I would say that is correct.

Q. And, of course, the opinions that you expressed in response to questions which asked you to assume certain facts were influenced by the facts which you assumed in giving your answers?

A. Oh, definitely.

Q. This is true, is it, Mr. Webster, as a certified public accountant, if you were called upon by the Westvaco Chlorine [497] Products Corporation to set up their cost accounting for them, before you could determine the proper methods and accounting principles to be employed in the cost accounting of gypsum, you would have to go over to the plant and make a thorough study of their processing operations, would you?

A. That is correct.

Q. And you would have to know something about the origin of the plant, would you?

A. Probably.

(Testimony of Paul K. Webster.)

Q. So you are not in a position to state as a fact whether gypsum is a product which by its nature should be considered for accounting purposes as a by-product or a co-product, is that true?

A. That is correct. I have not visited the plant. I do not know what the processes are.

Q. Let me ask you this: You have testified in the abstract that a by-product is to be treated for accounting purposes different than a joint product or a co-product, is that right?

A. That is correct.

Q. How do you define a by-product in that sense?

Mr. Bennett: Of course, your Honor, again I raise the objection that I have heretofore, that the contract in this case specifically states that this is a by-product. Gypsum, the product with which we are dealing, is a by-product and that therefore the defendant is estopped to deny in this proceeding, or otherwise, so far as any right or obligation of the plaintiff is concerned, the fact is so far as the application of the contract is concerned, that this so-called escalator clause, paragraph 6 of the contract, or the price to be paid under that or other clauses of the contract, should be based on any other consideration than the fact that the product covered by the contract is a by-product.

The Court: We are discussing here the proper method of allocating cost.

Mr. Bennett: Yes.

The Court: And to exclude and just limit the testimony to one phase of the case, how am I to

(Testimony of Paul K. Webster.)

determine what is the proper method of allocating the cost of these products, or any of them?

Mr. Bennett: The point I make, your Honor, is the contract binds the parties and the court, in so far as determining what character of product it is, that it is a by-product because the parties have agreed by contract that it is. Now, this question is designed, as I take it, only for the purpose of attempting to show that this product was perhaps something other than a by-product.

The Court: Keep in mind the examination you went into with your own witness with relation to co-products.

Mr. Bennett: That was opened up, your Honor, merely for the purpose of showing the different methods of accounting [499] that applied to a co-product and the method that applies to a by-product, but I did not open up and, as your Honor recalls, I strenuously objected to any attempt by the defendant in this case to prove or to establish the fact that this product was something other than a by-product, because I have always maintained, as your Honor recalls, from the start of this case, that the contract, by agreement of the parties, established this product as a by-product. Therefore, it is not proper for the defendant to dispute the character of product or attempt to show to this court that, in fact, it is something other than a by-product. That is the only point I make, and that was my assumption, that the purpose of this question was to attempt to establish by the cross-exam-

(Testimony of Paul K. Webster.)

ination of this witness that in fact this gypsum was not a by-product but is, in fact, a main or a co-product.

The Court: For the purpose of the record, you may indicate the purpose of the offer.

Mr. Rosenberg: I think I have stated on a number of occasions, and the court has so ruled, that it is true in chemistry or in the vernacular of the chemical industry, this may be a by-product, but this witness is testifying as to the treatment of the product in the accounting field, and the term may have an entirely different meaning in accounting practice than it has in the chemical industry.

The Court: For that limited purpose, I will allow it. [500] The objection is overruled.

Q. (Mr. Rosenberg): Will you tell me, Mr. Webster, how you define a by-product as the term is used in accounting practice to distinguish between a by-product and a joint product or a co-product?

Mr. Bennett: May my objection run to this line of questions?

The Court: Very well. Let the record so show.

A. An exact definition of a by-product is a little difficult because the term "by-product" is used to refer to a rather wide variety of products. Generally, however, a by-product is produced as an incident to the production of some other product or products, which are usually referred to as the main product or perhaps joint products. The by-product comes off during the process as an

(Testimony of Paul K. Webster.)

automatic thing almost; again, such as sawdust in a sawmill. You have to produce the by-product to produce the main product. The by-product may be immediately salable or it may at the point of separation be a waste material which requires further processing in order to make it salable, but basically, it is a product which is produced as an incident to the production of something else.

Q. (Mr. Rosenberg): Do I understand by that that for accounting purposes your opinions are influenced by the assumption that the amount of gypsum that is produced is incidental to and dependant upon the quantity of magnesium oxide that is produced? [501]

Mr. Bennett: Just a moment. In addition to the other objection I wish to state to the court that this question assumes facts not in evidence. My questions to the witness were based on the hypothesis that gypsum was a by-product. Now, obviously he based his testimony, so far as accounting in this situation is concerned, on the assumption that it was a by-product, because my questions laid that predicate.

The Court: Read the question.

(Question read.)

The Court: The objection is overruled. He may answer.

A. I think quantity would not be basic there. In other words, the volume of the by-product would not be a controlling factor.

Q. (Mr. Rosenberg): My point is this: Whether

(Testimony of Paul K. Webster.)

or not the opinions that you have expressed as to the treatment of gypsum as a by-product are premised upon the assumption that the gypsum is produced incidental to the production of magnesium oxide?

A. Yes, I think that is a fair statement.

Q. So that therefore the amount of gypsum that is produced, whether it is or is not produced would depend upon whether or not magnesium oxide is being produced?

A. I do not quite understand that.

Q. In other words, your assumption is that gypsum is produced incidental to the production of magnesium oxide?

A. That is correct.

Q. So that it would follow from that, wouldn't it, whether or not gypsum is produced would depend upon and to the extent that magnesium oxide is being produced.

A. I can't answer that. I do not know.

Q. You can't state that. Will you concede this, Mr. Webster, that there is a school of thought in accounting circles who feel that if you are going to determine the cost of producing a by-product you should employ the same principles and practices as you employ in determining the cost of a joint product or a co-product?

A. I will concede that you can find so-called authorities which give a large number of different methods of accounting for by-products, the most common of which is not to account for the cost of by-products at all.

(Testimony of Paul K. Webster.)

Q. That is right.

A. The second of which is to account for by-products separately on some basis or other, of which there may be several variations, which have to be adapted to some degree to the problem at hand.

Q. In other words, you do not want the court to understand that the recommendation that you made or the opinions that you expressed are uniformly accepted in accounting circles? There are some people, are there not, in accounting circles, and reputable authorities who think that if you are going to determine cost of producing a by-product you should apply the same principles [503] and accounting methods as you do in the case of a joint product?

A. I think that that depends on the circumstances. The authorities would not say that in all cases you should apply any one method to accounting for by-products. In other words, you have to consider all the circumstances and adapt your accounting methods to the circumstances of the individual case.

Q. It is true, then, in certain circumstances good accounting practice would permit the determination of cost of producing a by-product in the same manner as the determination of the cost of a joint product or a co-product?

A. Yes, although I suspect that that is true only in cases where the so-called by-product is perhaps in fact a co-product or a joint product. In other

(Testimony of Paul K. Webster.)

words, where you are approaching a factual situation that justifies similar treatment for a by-product to what you have for a co-product.

Q. Can you conceive of this, Mr. Webster, that in a chemical operation such as this, where you start with this bittern and you are putting it through three departments, so to speak, where you recover bromine in one department, gypsum in another department, and magnesia in another department, that they might very properly be considered co-products for accounting purposes?

A. That is a possibility, I would say.

Q. I believe you stated also that even in cases where the by-processing or refinement to make it a commercial product, under certain circumstances it is good accounting practice [504] not to even determine any cost of the expense involved in processing and refining after the point of separation, isn't that true?

Mr. Bennett: Just a moment. May I have that question read?

(Question read.)

A. Yes, that would be true in cases where you credit the entire proceeds against the cost of the main product, and perhaps make no separation of the cost of the by-product from the main product. That is a method which is sometimes used.

Q. So in those cases the direct labor and other expenses performed after the point of separation are merely considered as cost of the main product?

(Testimony of Paul K. Webster.)

A. Well, as a part of the total cost, not the cost of the main product necessarily.

Q. Let us see if I understood your testimony yesterday: Do I understand you to say that in your opinion, in determining the cost of producing a by-product, it is improper to include any overhead expense or any indirect charges, the precise amount of which attributable to the processing of the by-product cannot be determined?

A. Well, I think I did not use the word "precise." However, generally you stated my position and under certain assumed conditions.

Q. Under certain assumed conditions. Of course, that is not true as to a joint product or a co-product, is it? [505] A. No.

Q. In other words, in the case of a joint product or a co-product there are certain expenses where you are producing more than one product which you know contribute to the production of the various products, but you can't, as a matter of accounting, say accurately how much for each product? A. Yes, that is correct.

Q. So those expenses—is it proper to term them indirect expenses?

A. Oh, that is a question of the individual method of accounting. I think it will suffice for this purpose.

Q. So those indirect expenses you allocate between the various products you are making, co-products or joint products, on some rational basis, is that correct?

(Testimony of Paul K. Webster.)

A. That is correct. I should like to extend that answer a bit, though, to point out the reason for that is that you are in business to produce several products, and your cost should be allocated on some equitable basis among those products. In the case of a by-product, however, you may or may not recover the by-product, and consequently you are justified, in my opinion, in applying somewhat different principles to determine whether or not you should recover that by-product at all, by avoiding charging to the by-product expenses which would go on regardless of whether you produced the by-product.

Q. But getting back to this apportionment now, you have to [506] allocate among co-products or joint products on some rational basis, is that right?

A. That is an accepted method.

Q. In other words, that is an accounting expediency, you might say, because you can't state with accuracy how much of this indirect expense actually contributed an amount to each product, so you have to adopt some rational basis of allocating, is that right.

A. That is right.

Q. And there is a variety of methods employed in good accounting for allocation of those indirect expenses, is there?

A. Yes, but I would not consider it good accounting unless the method of allocation bore some resemblance to a proper allocation based upon the circumstances.

Q. Yes, and in accounting you use different

(Testimony of Paul K. Webster.)

media according to circumstances and what the accountant in his good judgment thinks is the best method to approximate the actual?

A. That is right.

Q. It might be labor, it might be value, is that right?

A. That is right.

Q. It might be volume?

A. Right, and it might be different bases in the same operation, as a method of allocating different items of cost.

Mr. Bennett: We are still talking about co-products and joint products? [507]

Mr. Rosenberg: That is right.

Mr. Bennett: As distinguished from by-products.

Q. (Mr. Rosenberg): Assume, Mr. Webster, you have a plant such as the Westvaco plant at Newark, and you start with this sea water from which the Leslie Salt Company has taken salt. Was that process explained to you?

A. Yes, I understand generally.

Q. And we call that bittern after the salt has been taken out. Would you, in the light of the definition that you gave of a by-product, be willing to assume that this bittern is in itself a by-product of the Leslie Salt operations?

Mr. Bennett: I submit that that is wholly immaterial.

The Court: I was turning that over in my mind. I want that answer. You may answer it.

A. I haven't enough information about the

(Testimony of Paul K. Webster.)

process to know. It might be a by-product to the manufacture of salt. On the other hand, it might not be.

Q. (Mr. Rosenberg): So you think it is a reasonable assumption that the primary purpose that the Leslie Salt Company has in mind is to get salt?

A. Yes, but it might not be economical for them to produce the salt unless they sell the bittern.

Q. And that would be equally true in this plant, wouldn't it? It might not be economically feasible to produce the magnesium oxide without recovering something from the gypsum, isn't that [508] true?

A. That is a possibility.

Q. You do not know what the fact is in that regard?

A. I do not, no.

Q. Just assuming this plant—and we start with this bittern—was this magnesium process explained to you that precedes the gypsum process and the magnesia process?

A. Only in a general way.

Mr. Kaapeke: You mean bromine.

Mr. Rosenberg: I am sorry. I mean bromine.

Q. (The Court): You were in the courtroom when they were examining in relation to this chart?

A. From time to time.

Q. Are you familiar with the chart now?

A. Generally so.

The Court: Proceed.

Mr. Bennett: Your Honor, for the record I wonder if he should not identify this chart with some designation.

(Testimony of Paul K. Webster.)

The Court: Very well.

Mr. Rosenberg: This chart is not in evidence.

Mr. Bennett: I would like to have it admitted for identification at this time.

Mr. Rosenberg: I would certainly object to that going in evidence because, as I stated before, it is not accurate, and it is not complete.

Mr. Bennett: Counsel, I am asking for it to be identified. [509]

Mr. Rosenberg: That is all right.

Mr. Bennett: Marked as an exhibit for identification, because both you and I have referred to this chart from time to time.

The Court: Let it be admitted and marked for purposes of identification.

(The chart referred to was thereupon marked Plaintiff's Exhibit 16 For Identification.)

Q. (Mr. Rosenberg): Now, in the course of your examination, Mr. Webster, Mr. Bennett referred to indirect charges which would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts, and I believe you expressed the opinion that in determining cost of production that such indirect charges should be excluded; is that right?

A. Well, that was—the point there is that here you have a by-product, or we are discussing a by-product which might or might not be saved and sold. Accordingly, it seems to me that you are justified in determining the cost of a product on the basis of the items that you can identify and ascer-

(Testimony of Paul K. Webster.)

tain as being directly related to the saving and selling of that product, as compared to discarding it. It is my contention that in most cases if you have items of the type that are referred to there they may be identified and considered direct charges into somewhat nebulous overhead items or indirect items, which is perhaps somewhat partially applicable to the by-product. [510]

Q. You are not speaking of indirect charges as being nebulous merely because as between different products you have to allocate them on a somewhat rational basis, you would not call that nebulous?

A. No; merely because it is applicable to by-product it is nebulous.

Q. That all depends on what you are talking about? A. Yes.

Q. What I am trying to find out is whether or not you would state as an expert that any charge that has to be allocated for inclusion in cost of production of a by-product merely by virtue of the fact that the amount has to be determined upon some reasonable method of allocation——

A. Well, I would say it is objectionable but not necessarily totally excludable. It would depend on the circumstances.

Q. Let's go back to the shipping department. Assume you have a shipping department where you are shipping several products, and we may assume for the moment that one of them is a by-product, and that you keep accurate records of the direct labor and expense in the shipment of those

(Testimony of Paul K. Webster.)

various articles, including the by-product, but in addition to that you have a shipping foreman, superintendent, an assistant shipping foreman or an assistant general supervisory employee or employees who are essential to the proper operation of that shipping department, and they actually handle all three products, [511] including the by-product; is it your considered expert opinion that merely because you would have to determine the amount of that labor reasonably attributable to the by-product by some method, some reasonable method of allocation, that the charge is objectionable for that reason?

A. Well, there are a number of angles to that question. In the first place, you have the question as to whether those shipping expenses, any shipping expenses——

Q. I am asking you to assume——

A. In the second place, there is a question as to whether these so-called indirect items would be reduced if you did not have the by-product.

Mr. Bennett: We are getting into a very complicated picture here that is not germane to the issue in this case. The question is very complicated and, besides, no matter how able a witness is he cannot——

Mr. Rosenberg: Mr. Bennett, if he does not understand it I am sure he will tell me. I don't want to be unfair with the witness and I am sure he is trying to be fair with me.

Mr. Bennett: Your question is complex.

(Testimony of Paul K. Webster.)

The Court: Let us proceed, gentlemen. For the purpose of the record, the court is now prepared to rule. The objection will be overruled. Proceed. Because this contract happens to represent a by-product does not exclude methods of allocating cost under the case here presented. I have indicated that now for the purpose of the record. Now we will proceed.

Mr. Bennett: I am not quite clear as to the court's remarks.

The Court: Proceed.

Mr. Rosenberg: Do you understand my question?

Mr. Bennett: I wanted the reporter to read the remarks made by the court.

Mr. Rosenberg: I think the court said merely because the contract states what is a by-product it does not exclude the evidence that is being elicited from the witness.

The Court: That is exactly what I said. I said more. I said I was going to allow the widest latitude. This is a field of experting accounting and it will be helpful to have the record disclose as much assistance as this court can get. For that reason I am going to allow this testimony.

Mr. Bennett: Your Honor understands my objection is as to the form of the question, that it was complex——

The Court: If there is anything complex——Is there anything complex about the question?

The Witness: I think I understand the question.

(Testimony of Paul K. Webster.)

The Court: He says he understands the question.

Mr. Bennett: All right, if he understands it.

Mr. Rosenberg: Do you remember the question?

The Witness: I would rather have you restate it.

The Court: Reframe your question.

Q. (Mr. Rosenberg): Mr. Webster, I believe that the question [513] that I asked you is this: That is it your position and your expert opinion that where you have a shipping department that is shipping out a number of different products, one of which is a by-product, and as a necessary expense to the operation of that shipping department you have supervisory employees, such as a foreman or an assistant foreman and a shipping clerk, we will say who is not supervisory but who performs general service in relation to the various products, including the by-product: Is it your expert opinion that because you would have to determine the amount of those expenses incident to the shipment of the by-product by some method of allocation, that it would be improper in determining the cost of shipping expense for the by-product to include any proportion of any general service or indirect charges if we may call them such?

A. I would not consider it improper if it can be shown that a portion of those expenses were incurred merely because of the shipment of the by-product.

Q. Why do you distinguish there, let us assume we are only shipping two products, one is a major

(Testimony of Paul K. Webster.)

product and one is a by-product. Let us assume that the volume or the quantity of the by-product is equal to the volume or the quantity of the main product.

Mr. Bennett: Just a moment. To keep the record straight, I think my previous objection about this being improper cross-examination—the parties are bound by the definition in the [514] contract—will run to this line of questioning?

The Court: Let the record so show.

Mr. Rosenberg: Do you understand the question, or did I get a chance to complete it?

The Witness: Yes, I understand it.

The Court: Where there are two products.

A. That's right. My answer would be that if the volume of the by-product were so large as to constitute a major portion or substantial portion of the shipping department expense, and it should not be possible to figure direct charges specifically to the by-product, and a very substantial amount of it can be shown under the expense of the department were largely cost of the shipping of the by-product, then I would say to that extent that the expenses were attributable to the by-product and should be so accounted for.

Q. (Mr. Rosenberg): Are you talking about direct charges where if we charged that——

A. I don't care so much what the method of accounting is. I am talking about charges that are attributable to the by-product, or the operation.

Q. For our purposes, assume in a chemical plant

(Testimony of Paul K. Webster.)

they are shipping two products, one of which is a main product and one a by-product. and assume also that as far as direct labor that is employed in the shipment of those two products accurate time card records are kept, and that labor is charged directly, and [515] in addition you have a shipping clerk, a shipping assistant foreman that divide their time without keeping accurate record of it between the shipments of the two products, and assume further that the quantity or volume of the two products is approximately equal, would you say that in addition to the direct charges directly attributable to the by-product that it would be improper to charge also a portion of the indirect charges, so to speak, of the superintendent and the shipping clerk?

A. I wouldn't say it would be improper under those basic assumptions as a method. However, the way I should prefer this to ascertain whether or not you should save and sell a by-product as compared to discarding it at some point in the process, and you would then charge against the by-product only those expenses which you would not have if you did not save and sell the by-product.

Q. Mr. Webster, if you were going to determine as a practical matter in a chemical plant whether it was economical to save and sell a by-product you would take into consideration all expenses that are incident to processing and the sale of that by-product, wouldn't you?

A. Yes.

(Testimony of Paul K. Webster.)

Q. That is something which is a matter of accounting and is impossible to ascertain accurately.

A. In minor cases perhaps, yes; generally, I think not.

Q. Well, let's forget about by-products, for the moment, and [516] say you had a plant that is producing 10 co-products, and you are trying to determine how much your expense, your general overhead and your indirect charges will decrease if you discontinue one of those products. That is something that is a practical impossibility from an accounting viewpoint, is it?

A. I think not.

Q. Surely, with accuracy.

A. Well, in minor respects, yes, but in major items, no.

Q. What do you call major items and what do you call minor items? Let's take a concrete example, I believe you have conceded that in the case of a co-product general and administrative expense is a proper item to include in determining cost of production, have you not?

A. No, I have not.

Q. You have not.

A. It is something done, but it is not always done.

Q. It is good accounting practice——

A. Well, generally your administrative expense is such a broad term, I think there is a definite method as to the subject of general and administrative expense.

(Testimony of Paul K. Webster.)

Q. All right, I will be more specific. Say you had a plant that is producing 10 products, all joint products, and you have got a plant superintendent and an assistant superintendent, and you are trying to decide whether you are going to discontinue the production of one of those ten products. You can't tell [517] me how much of the expense of the shipping plant, say, will be decreased by the elimination of that one product, can you?

A. That would depend upon the circumstances. In some cases you might.

Q. As a general rule it would be impossible to determine, wouldn't it?

A. If one were a minor product you probably could; if it were a major product, I think you could make a pretty good estimate.

Q. In other words, you feel as an accountant you could tell if you were going to discontinue one of ten equally main products, do you, you could tell your general and administrative expense would come down as a result of that?

A. I would say you could make a pretty good estimate.

Q. You could make an estimate, but it would be unascertainable from an accounting point of view?

A. Precisely, yes.

Q. That is the language that is used in here, that is typical of the type of expense that would probably continue but in somewhat lesser and unascertainable amounts?

Mr. Bennett: Just a minute. Let's keep the record straight.

(Testimony of Paul K. Webster.)

Mr. Rosenberg: I am talking about——

Mr. Bennett: Your question said, “That is the language used here.”

Mr. Rosenberg: The language that you read to the witness:

The Court: We will take a recess.

(Recess.) [518]

Q. (Mr. Rosenberg): Mr. Webster, to go back to shipping, would this be true, that assuming gypsum is a by-product, if you had a separate shipping department and in that shipping department you had a foreman and an assistant foreman and a shipping clerk and they devoted their time exclusively to the shipment of gypsum, you would not question the propriety of including the expense of those employees in determining the shipping expense of the gypsum, would you?

A. No, because under those circumstances the items would both be ascertainable and directly applicable to the product.

Q. Going back to the assumption of co-products again, if you had, we will say, three products being shipped out of the shipping department, you would include in the shipping expense for those three products some proportionate share for each product of the supervisory employees, making your allocation on some rational basis, would you?

A. That would be a proper method if you accounted for shipping expenses that way.

Q. Let us take another example of this type of expense. Let us take laboratory and assume that

(Testimony of Paul K. Webster.)

at the Westvaco plant at Newark a laboratory is conducted for the purpose of testing and analyzing samples of the various products that are produced at the plant, including gypsum, and as to gypsum, for the purpose of testing the product to see that it comes up to the specifications of a contract governing the sale of the product: would [519] you say that it would be improper to include in the cost of producing gypsum a reasonable proportion of the expense of the laboratory in which these services are performed for gypsum?

A. Speaking of gypsum now as a by-product?

Q. Yes.

A. I would say that it should not be charged to the by-product unless it was ascertainable in amount and definitely attributable to the by-product.

Q. But if you have a number of co-products your opinion would be different, would it?

A. That is correct.

Q. And if you keep accurate time records of the time devoted to each of the products which are tested and analyzed and worked on in the laboratory, including gypsum, and again assuming that it is a by-product, then you have certain indirect expense such as a superintendent chemist who has supervision of the laboratory and you allocate the expense of his salary between the various products, including gypsum, in proportion that the direct labor charges attributable to each product bear to the whole, would you say that that would not be a proper accounting practice?

(Testimony of Paul K. Webster.)

Mr. Bennett: In a by-product?

Mr. Rosenberg: I have said that, Mr. Bennett.

Mr. Bennett: Thank you.

A. Well, we go back to the same standard, keeping in mind, as [520] we already have said, there are several possible methods of accounting, but the standard by which I am inclined to judge the problem we have before us is whether or not the charge is ascertainable and directly and solely attributable to the production of the by-product, and under the circumstances which you have mentioned I would say that the direct laboratory expenses were definitely attributable to gypsum, if the accounts were so kept, that the overhead expenses which would go on anyway, regardless of the production of gypsum, would be very questionable and should not be charged unless they can be ascertained.

Q. Where you stated there were several different methods, then I assume you will agree that some other good accountant might have a contrary opinion and might feel that those indirect expenses should be included, is that true?

A. We have already pointed out that there are numerous methods referred to in texts on account for by-products, but that the important thing is to adopt the one which seems suitable in the individual case.

Q. So that some other reputable certified public accountant might hold a view that is contrary to yours, isn't that true?

A. I would consider that a possibility, certainly.

(Testimony of Paul K. Webster.)

Q. There are text writers and persons who have written treatises on the subject who hold to the opinion that in the case of a by-product which requires processing for the purpose of [521] making it a commercial product, you should determine the cost of production in the same manner as you would determine the cost of production for a co-product, isn't that true?

A. Well, as I have already stated, I think that those methods are applicable only when your product actually is not a by-product at all but actually is a co-product.

Q. Well, it is very difficult to distinguish and determine in a particular case what is a true by-product and what is not for accounting purposes, isn't it, Mr. Webster?

A. Well, there must be borderline cases. There are some cases where it is not difficult at all to distinguish and there are others where it may become difficult to distinguish.

Q. And in a chemical plant where you start with this bittern water and recover from it first bromine and then in another process you recover gypsum and then in another process you recover magnesia, it is conceivable that for accounting purposes those could all be treated as co-products, isn't it?

A. I can hardly answer that question based on the limited information I have about the processes and the products. It is conceivable that that could be true. Whether it is true or not, I do not know.

(Testimony of Paul K. Webster.)

Q. I believe your attention was directed to this exhibit F and the defendant's answers to plaintiff's interrogatories. I think your attention was directed to the item fuel oil, and your commented on the fact that it appears that in the period [522] 1945-1946 there was a charge of 1 per cent per ton and at a preceding period there was no charge, and I believe—and if I am incorrect, please correct me—that you stated that you would deduce from that that there had been some change in accounting methods in the two periods, is that right?

A. No, no, what I mean to say was there might have been a change in the nature of fuel used in the process but there might have been a change in accounting method. It could be the result of either.

Q. Let us assume, Mr. Webster, that that charge in the second period did not occur in the first period and did occur in the second period by reason of circumstances beyond the control of the producer. Then that would be an increase in cost to the producer, wouldn't it?

A. Let me assume some circumstances in answering that question. Assume that the ordinary fuel was natural gas, that the natural gas was not available during the second period but had been available during the first period. If it had been necessary for them to use fuel oil instead of gas in the second period, presumably that would be an addition to their costs for that period. Whether it would be an addition to the cost properly allowable under this contract might be subject to question——

(Testimony of Paul K. Webster.)

Q. No. Pardon me.

A. —because of the fact that it might be necessary for comparative purposes to assume some similar charge in the first [523] period in order to avoid distortion of the comparison.

Q. But from a strictly accounting viewpoint you would say, then, that the cost of production in the second period increased as compared to the first period, whether or not it is an increase that would be allowable under the contract?

A. Yes, If it costs them more to use fuel oil than it would have cost them to use gas, if that was not available, that would be true.

Q. Would you say this as an accountant, and being abstract again, that any new expense and additional expense that arises in the course of the manufacture of the product by reason of a change in circumstances that did not exist in a prior period would, as a matter of accounting, represent an increase in cost of production in the second period as compared to the first period?

A. You are speaking now of a cost of production of the by-product?

Q. Yes.

A. Then I would say yes. If the cost were directly attributable to the by-product.

Q. Yes. In other words, if it is a cost which in your opinion is a proper cost to be included in determining the cost of producing the by-product.

A. Yes, that seems a correct statement.

Q. In your testimony yesterday regarding taxes,

(Testimony of Paul K. Webster.)

I think there [524] is an error in the transcript and I would like to give you an opportunity to correct your answer.

Mr. Bennett: What page?

Mr. Rosenberg: Page 491, line 10.

Q. Speaking of taxes, you stated, "However, if the allocation were on the basis of value, there might be a serious objection to it," and I believe your testimony was "there might be no serious objection to it," isn't that correct? A. That is correct.

Mr. Rosenberg: We may consider the transcript corrected, may we, Mr. Bennett?

Mr. Bennett: Yes, and I might say I think we both agree there are numerous other corrections that we will make in due time, counsel.

Mr. Rosenberg: Yes.

Q. As far as taxes are concerned, where you have a chemical plant where there are various units in this plant for tax purposes, they are assessed as a whole ordinarily, are they not, Mr. Webster?

A. I could not answer as to the procedures that an assessor would use in that situation. It might be assessed as a whole. Frequently they are assessed by reference to individual items in the plant and I think a breakdown could be obtained from the assessor if it were requested.

Q. Let us say property taxes are assessed on the plant as a [525] unit, and assume also that it is possible to segregate the entire plant and divide it into separate units, exclusively devoted to the

(Testimony of Paul K. Webster.)

production of separate products, and having done so, that you allocate the total tax between the several units in the relation that the plant values of the separate plants bear to each other. Do you believe that that might result in a reasonably accurate result?

A. Probably more information would be necessary, but along those lines it seems an accurate result could be obtained.

Q. In the course of your testimony regarding the charge of this bittern, you stated, at page 481, line 7, of the transcript, as follows:

“It would seem to me that the purpose of using bittern as you have described it would be to produce the main product and not the by-product and I would not be inclined to allocate any of the basic material costs to the by-product.”

Now, that assumption was not based upon any actual or factual knowledge of the processes of this plant, is that true?

A. That is true. It was based upon the assumption that gypsum here is a by-product.

Q. Let us assume this, Mr. Webster: Let us assume that this plant at Newark is producing bromine, gypsum, and magnesia products, and let us assume that there was a contract covering the sale of the magnesia products, in which contract the price to be paid is dependent upon the cost of producing the [526] magnesia products, and let us assume that you were employed by the buyer under that contract of the magnesia products to determine

(Testimony of Paul K. Webster.)

the cost of production of magnesia and, consequently, the price that your client is going to pay for it, and assume that you went over the books and records of the seller and you found that all general expense, all supervisory expense, all overhead expense, all indirect charges were charged to magnesia and no portion of it charged to gypsum or to bromine. Do you think that as an expert accountant, and having in mind the service to your client, that you would approve of that method of accounting and would you approve the magnesia being burdened with all overhead and all indirect charges, or would you be inclined to take the position that inasmuch as the gypsum is being produced in the plant, it should bear some portion of those charges and that your client should not be obliged, through the purchase of the magnesia, to pay them all?

A. Your first question would be the provisions of the contract under those circumstances, and presumably the contract would indicate what assumptions were to be made in the determination of costs. However, in the absence of that, if magnesium oxide were the main product of this process and the other products were by-products, I should expect the cost of the main product to be reduced by the amount recovered from the sale of the by-products.

Q. Let us assume that you found out that the same seller had a [527] contract for the sale of the gypsum where the price of the gypsum is depend-

(Testimony of Paul K. Webster.)

ent upon the cost of producing the gypsum, so that it becomes necessary for the purpose of that contract to determine the cost of producing the gypsum. Now, under those circumstances and having in mind that the cost of production of gypsum must be determined, would you, in service to your client, approve an accounting setup whereby your client, as the buyer of magnesia, would be saddled with all the overhead expense and indirect charges of this chemical plant?

A. If the gypsum were a by-product, and if the cost of production of the main product has been relieved of either the proceeds from the sale of the by-product or the cost directly attributable to the production of the by-product, I think there would be no ground for complaint.

Q. But you would insist on the aggregate recovery from the gypsum being treated as a reduction in the cost of the magnesia?

A. Either the aggregate recovery or the direct cost.

Q. But you would be perfectly willing for your client to pay a price for the magnesia based upon a cost of production which includes all overhead expense and all indirect charges in the plant, would you?

A. If that were the main product, and if the so-called overhead did not include items directly applicable to the by-product.

Q. May I just ask you this, Mr. Webster: Do you have readily available any treatises or texts or

(Testimony of Paul K. Webster.)

papers in which any [528] accounting authority has expressed the view that where you are going to determine the cost of producing a by-product it is improper to include overhead expense and indirect charges?

A. The difficulty with texts in general is that, in the first place, they are frequently written by college professors or others who are interested largely in the theoretical aspects rather than the practical aspects of the situation; and secondarily, they are trying to cover so many phases of the situation that they do not cover any one phase adequately. I have read numerous treatises on cost accounting and related matters. Many of them have no relation whatever to by-product accounting because it is a relatively minor phase of the science of cost accounting.

Furthermore, citation of those texts would not be very helpful because it is generally impossible to determine under what circumstances the texts were written. There is no way of determining what the author had in mind when he made a certain statement. The thing that is most apparent from reading texts on cost accounting and what you can find about by-product accounting is that the usual attempt is to cover the field very generally, presumably for the purpose of touching upon various phases of the problem and perhaps stimulating the thinking of students in relation to those problems. And I am not prepared to cite any particular text or article which would be particularly helpful

(Testimony of Paul K. Webster.)

in the determination of the problem we have in hand.

Q. So that you do not have anything of that sort? A. No.

Mr. Rosenberg: I think that is all.

Redirect Examination

Q. (Mr. Bennett): If, Mr. Webster, your client was the purchaser of a by-product where the contract or arrangement between the parties provided that the cost of that product to the purchaser, your client, should be based in connection with the actual cost of production or the cost of manufacture of the by-product, state what items you would consider proper in an accounting point of view to be included in the cost of production or cost of manufacture.

Mr. Rosenberg: I object on the ground it has been asked and answered and it is not proper cross examination and on the further ground when I asked the witness a question about the contract he said he would have to see the contract.

Mr. Bennett: Your Honor, that is hardly correct. Counsel asked, and Your Honor noted the last questions all had to do with a hypothetical situation where this witness——

The Court: I will allow him to answer the question.

A. In determining the cost of a by-product under the contract——

Mr. Bennett: The cost of production.

A. The cost of production of a by-product.

(Testimony of Paul K. Webster.)

Q. Or cost of manufacture. [530]

A. I should consider as applicable to that problem those costs which were directly and solely attributable to the production of the by-product and were identifiable or ascertainable as such.

Q. You would exclude other items of cost?

A. I would exclude items which did not fall within that definition.

Mr. Bennett: I am doing this to be of some aid to the Court in summarizing the witness' testimony in line with the cross examination. Will you take Exhibit E of defendant's answers to interrogatories?

The Court: What page?

Mr. Bennett: This is Exhibit E—if you wish me to turn to it, I will.

Q. Keeping in mind the identification or classification of the items of charges for the two year comparative period, namely, the year 1943 with the year 1942 and also the explanation of the manner of determining or measuring the costs as appears on the left column, will you state what items of increase, if any, shown for the year 1943 would be included under your view and experience as proper to be included in the increase, the actual advance in the cost of production.

Mr. Rosenberg: Just a moment. Are you offering that in evidence? Are you going to have the same argument we had about F? [531]

Mr. Bennett: I am referring the witness now to Exhibit E of the defendant's answers to plaintiff's interrogatories, Your Honor.

(Testimony of Paul K. Webster.)

Mr. Rosenberg: This is not in evidence.

Mr. Bennett: Well, I will offer this Exhibit E in evidence as the plaintiff's exhibit next solely for the purpose of showing the claim and representation and statement of the defendant in answer to plaintiff's interrogatory as to the claimed or alleged items of cost of manufacture pertaining to the product in question and the contract in question for the year 1943 over the year 1942.

The Court: Let it be admitted and marked.

Mr. Bennett: And the explanation as given in the right-hand column by the defendant.

(Exhibit E to defendant's answer to plaintiff's interrogatories was received in evidence and marked Plaintiff's Exhibit 17.)

PLAINTIFF'S EXHIBIT No. 17

	Year	Year	
	1943	1942	
9.			
(a)	\$2.71	\$1.93	
(b) Labor—Operations	.39	.26	Actual time card dist.
Labor—Repairs	.16	.12	Actual time card dist.
Comp. Ins. & S.S. Taxes	.03	.02	Follows Labor
Materials—Operations	.02	S'room req. & Direct Purch.
Materials—Repairs	.07	.06	S'room req. & Direct Purch.
Bittern (1)	.20	.20	Arbitrary Allocation
Water	.01	At cost—measured
Power	.18	.15	At cost—measured
Fuel	.14	.10	At cost—measured
Overhead (2)	.82	.42	Allocated—Labor basis
Taxes, Ins. & Depr. (3)	.49	.41	Allocated—% roughly based on plant value
Inter-departmental charges	.01	At cost
Ship. Expense (4)	.19	.10	Actual cost plus pro-rate of Misc. Ship. Expense

(Testimony of Paul K. Webster.)

	Year	Year	
	1943	1942	
9.			
(c) (1) Gypsum	.20	.20	per ton
Bromine	16.60	15.80	per ton
Magnesia	1.11	.96	per ton
(2) Gypsum	5.3%	5.0%	
Service Accounts	2.7%	2.9%	
Lime	11.6%	7.9%	
Ethylene Dibromide	17.1%	16.3%	
Magnesia	63.3%	67.9%	
(3) Gypsum	8.1%	7.1%	
Service Accounts	2.2%	2.1%	
Lime	25.2%	23.3%	
Ethylene Dibromide	11.2%	18.7%	
Magnesia	53.3%	48.8%	
(4) Gypsum	3.7%	6.2%	
Lime	11.1%	14.7%	
Ethylene Dibromide	4.6%	4.8%	
Magnesia	80.6%	74.3%	

Mr. Rosenberg: Mr. Bennett, isn't this going to be a reiteration?

Mr. Bennett: No, it is not.

The Witness: The first item, labor-operations, shows a cost here of 26 cents and 39 cents based on the actual time card distribution.

Q. How much is the increase?

A. That seems to justify an increase of 13 cents. My testimony, [532] of course, is based upon the acceptance of these figures as being a correct statement of what they purport to indicate.

Labor-repairs here indicate an increase of 4 cents. Compensation insurance and social security taxes which is stated "Follows Labor," I presume that means it is a direct charge, increase 1 cent.

(Testimony of Paul K. Webster.)

Materials-operations based on company requisitions and direct purchases show an increase from zero to 2 cents. Assuming again that there were no materials of that nature in the earlier period and that there is not a change in method of accounting, the 2 cent increase would appear to be allowable. However, if the comparable items in the earlier period were charged to some other account and should have been charged here, then the item should be entered in the 1942 column for the purpose of determining how much increase would be allowable, so with that qualification the increase of 2 cents may be allowable.

Q. Next item.

A. Material repairs, an increase of 1 cent appears to be all right.

Bittern, there is no change. Water, there is an increase of 1 cent, which appears to be a direct item. However, there is no item in the 1942 column and it again raises the question as to whether there may have been a change in the method of accounting. [533]

Q. But on the assumption that there was not.

A. The 1 cent would certainly be allowable as a cost item if it actually represents an increase. Power, increase 3 cents. This appears to be all right. Fuel, increase 4 cents, which appears to be all right. Overhead——

Q. Just a minute. In relation to overhead——

The Court: It has to do with labor?

Mr. Bennett: What did you say, Your Honor?

(Testimony of Paul K. Webster.)

The Court: On the labor basis?

Q. (Mr. Bennett): Assuming in relation to the items listed there as overhead, that item of overhead, that charge would have been incurred if the by-product had not been produced but in lesser and unascertainable amounts, would or would not that be included as cost of manufacture or the amount of any increase for the year 1943?

A. I think any item of this nature to be includable should be included on the basis of identification and ascertainment of the amount and, accordingly, based on the information before me at present, I would be inclined to exclude it.

Q. I will ask this specific question and I am referring now to the statement of the defendant, Your Honor, on page 7 of the answer to interrogatory 10(g), the second sentence of 10(g) on page 7. Assuming that those overhead charges listed there would have been incurred if no gypsum had been produced but in a lesser and unascertainable amount, would any increase in that [534] item be included or should be included?

A. In my opinion, no.

Q. What is the next item?

A. Taxes, insurance and depreciation which increased 8 cents.

Q. Assuming that that insurance relates to insurance other than social security and compensation insurance you referred to and allowed increased 1 cent in that period. State whether that would be allowed and if dependent upon any condition, what condition.

(Testimony of Paul K. Webster.)

A. Well, it represents——

Mr. Rosenberg: Just a moment: If you are going to write down any figures on that assumption, Mr. Bennett, I will object to the question on the ground that there is no foundation for that assumption. It assumes something that is not in evidence. This witness is on redirect examination and he is an expert witness.

Mr. Bennett: Well, I will reframe the question. Perhaps I can avoid the objection. Assuming that there is an increase in insurance in the amount of 1 cent in that period, state whether or not that should be included.

Mr. Rosenberg: I object to that on the ground it assumes something not in evidence.

Mr. Bennett: Counsel, so we can get along here and save time, I will ask you to stipulate if it is not a fact which should, I think, be before the Court, that in this summary of [535] charges that you furnished to the plaintiff after the case was filed and concerning which you introduced a letter yesterday to Mr. Kaapcke, shows that you claim that for the year 1943 there was an insurance cost for the gypsum operation, an increase of 1 cent over the preceding calendar year.

Mr. Rosenberg: Mr. Bennett, I am not going to stipulate as to what the contents of a written document are, because the written document is the best evidence and you don't require any stipulation from me. If you want to offer that in evidence you are perfectly free to do so. You told me

(Testimony of Paul K. Webster.)

the other day I was resorting to a trick. You have got that in evidence. If you want to put it in, you are free to put it in but don't ask me to stipulate what is contained in a written communication that I furnished to you because the written document is the best evidence of the information that was furnished to you.

Mr. Bennett: Well, I thought we could ask counsel to stipulate——

The Court: Where is the written communication?

Mr. Bennett: Right here. The communication that they gave to us outlining these matters.

The Court: Very well. Read from that.

Mr. Rosenberg: He can offer it in evidence. I have no objection.

Mr. Bennett: I see his purpose.

The Court: What is the objection to offering it in [536] evidence?

Mr. Bennett: Your Honor, I don't want to be bound by——

The Court: It is limited to that, of course.

Mr. Bennett: All right. I will offer it, this document entitled "Westvaco Charges Per Books to Cost of Production of Gypsum," consisting of five pages which the testimony already has referred to as being information which the defendant furnished to the plaintiff after the suit was filed and I offer it merely for the purpose of showing the charges claimed by the defendant and the costs alleged and asserted by the defendant for

(Testimony of Paul K. Webster.)

the calendar years 1937 to and including the year July 1, 1945 and to June 30, 1946. I am not offering it as evidence of the truth of the facts or figures shown upon the document, Your Honor, but to overcome the objection that counsel has to my request for a stipulation so we may proceed with the testimony of this witness.

Mr. Rosenberg: Just so the record may be clear, should be clear, I want to state that we object to any evidence relating to costs in the calendar year 1937, the calendar year 1938, the period from July 1, 1939 to June 30, 1940 and the period from July 1, 1940 to June 30, 1941, on the ground it is incompetent, irrelevant and immaterial and has no relation to any of the issues in controversy.

Mr. Bennett: I think that objection should be overruled because the testimony of this witness is not referring to that [537] period of time and if and when those matters are to be concerned, and they may well be concerned, Your Honor, we can dispose of the question when it arises.

The Court: I will allow it in subject to a motion to strike and over your objection.

(“Westvaco Charges Per Books to Cost of Production of Gypsum” was received in evidence and marked Plaintiff’s Exhibit No. 18.)

Westvaco Charges per books to cost of production of Gypsum

Summary

	July 1, 1945 to June 30, 1946		July 1, 1946 to June 30, 1947		Calendar Year 1947		Calendar Year 1948		July 1, 1940 to June 30, 1941		July 1, 1941 to June 30, 1942		Calendar Year 1942		Calendar Year 1943		Calendar Year 1944	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
TONS PRODUCED																		
Direct Charges	\$4,032.11	26.63	\$4,097.26	72	\$4,411.54	100	\$2,244.34	91	\$2,337.07	77	\$1,208.61	70	\$1,263.35	100	\$2,185.73	100	\$2,185.73	100
Overhead and General Plant Expenses	\$2,386.57	59	\$2,475.64	74	\$2,010.53	52	\$1,346.97	43	\$1,246.60	35	\$1,306.61	57	\$1,208.61	47	\$1,263.35	58	\$2,185.73	100
Bottom	\$3,774.58	6	\$1,554.23	18	\$1,704.53	20	\$3,655.23	20	\$4,064.45	1	\$2,520.73	10	\$2,712.5	60	\$2,712.5	100	\$2,712.5	100
Insurance	\$1,957.4	01	\$746.3	02	\$653.2	02	\$324.3	01	\$254.71	02	\$246.2	02	\$1,713	05	\$1,713	05	\$1,713	05
Taxes (on real and personal property)	7.44	02	\$66.67	01	\$68.41	01	\$467.35	02	\$717.55	02	\$746.71	02	\$550.82	02	\$550.82	02	\$550.82	02
Depreciation	\$3,116.37	30	\$2,583.22	38	\$1,997.35	45	\$2,221.65	35	\$1,022.31	34	\$901.493	32	\$774.349	71	\$774.349	71	\$774.349	71
Interdepartmental Water	\$244.42	01	\$237.26	01	\$75.00	01	\$44.35	00	\$45.30	00	\$57.06	01	\$59.81	02	\$59.81	02	\$59.81	02
Sulphuric Acid	\$5,573.42	25																
Superphosphate	\$1,588.37	04	\$1,169.52	04														
Total Cost of Production	\$10,375.10	25.4	\$7,254.75	23.1	\$14,705.52	25.2	\$5,495.70	17.4	\$3,314.07	16.0	\$4,197.70	14.7	\$2,718.05	25.4	\$2,718.05	25.4	\$2,718.05	25.4
Shipping Expenses (Retail not available)	\$10,676.61	28	\$7,091.51	21	\$7,320.04	19	\$5,554.37	18	\$5,720.32	15	\$5,369.58	19	\$4,636.0	13	\$4,636.0	13	\$4,636.0	13
Total Cost f.o.b. Cars	\$11,445.21	28.12	\$8,346.26	25.2	\$22,025.56	34.1	\$11,050.07	35.2	\$9,034.39	41.6	\$9,567.28	44.6	\$7,354.05	40.6	\$7,354.05	40.6	\$7,354.05	40.6

12754

2-23-48
J. J. J. J.
J. J. J. J.
J. J. J. J.

(Testimony of Paul K. Webster.)

Q. (Mr. Bennett): Assuming that for the period of the calendar year 1943, the costs of insurance increased on the claimed, or attributed to gypsum operations or properties increased 1 cent, should that be included?

A. Assuming that the item was allocated as being attributable to the gypsum operations and the basis of determining it is fair, then it may be considered a direct charge to gypsum and should be allowable.

Q. Those conditions that you have just mentioned, however, would definitely affect that question, whether or not they should not be included?

A. Yes.

Mr. Bennett: I am going to put up here, Your Honor, or down here, that item of insurance in question. (Indicating on blackboard.)

The Court: It is now about 12:00 o'clock and we will take a recess until 2:00 o'clock. [538]

Mr. Bennett: Your Honor, before you leave, may I ask a question? This witness has to leave—he has a very important engagement across the Bay that I noted to Your Honor yesterday. May I ask whether he could be called back out of order?

The Court: You will get me all out of order. The Court excused a witness before he concluded his testimony. Now, we are excusing another witness. How am I to follow his testimony?

Mr. Bennett: I was wondering if we could not accommodate the witness.

The Court: I will remain here until you conclude with him. How much time do you want?

(Testimony of Paul K. Webster.)

Mr. Bennett: I should say 5 or 10 minutes at the most.

The Court: Proceed. We will finish with him.

Q. (Mr. Bennett): The next item is taxes. Assuming that the taxes on the real and personal property affecting the alleged claim for the gypsum operations is the same in the two periods——

A. There would be no adjustment.

Q. In the case of depreciation, that the claim caused by depreciation for the calendar year 1942 was 38 cents and the calendar year 1943 was 45 cents and assume the depreciation was on the straight line method of calculation, state whether or not that item of claimed increase could be included.

A. I think it should be proportionate to the production. In [539] other words, if there was a substantial change in tonnage between the two periods that should be taken into consideration.

Q. Assuming that the tonnage of gypsum in the second period, namely, the year 1943, was 23 per cent less and the basis of the figuring or claiming depreciation was on the straight line, so-called straight line basis, then state whether you think that would be proper to include.

A. Can you tell me whether the amount of the straight line depreciation went up as between those two years?

Q. Assuming for the calendar year 1942 there was a depreciation claim of \$12,211.68, and for the calendar year 1943 there was a claimed deprecia-

(Testimony of Paul K. Webster.)

tion of \$11,099.35, or more than a thousand dollars decrease in the amount claimed for the second period.

A. Then I should think there would be no increase and possibly a small decrease.

Q. Next item.

A. Next item is interdepartmental charges which are not explained and are stated to be at cost. If they are directly attributable to the manufacture of gypsum, the increase of 1 cent would probably be allowable but it would require explanation as to the nature of the charge.

Q. Assuming that that particular item if charged would have been incurred if no gypsum had been produced but in a lesser and unascertainable amount, what would you say as to whether it should be included?

A. Then I think——

Mr. Rosenberg: I object to that. No foundation for that. The witness just said it would prove to him this was a direct charge.

The Witness: It is stated to be at cost, which would imply it is a direct charge, which would be allowable. I don't know the nature of the charge.

Q. (Mr. Bennett): Whether or not you would allow that would depend on whether it was a direct——

A. Whether it related specifically to the production of gypsum; also, there is the same qualification as to whether it was accounted for in the same way in depreciation on the preceding period

(Testimony of Paul K. Webster.)

because no charge appears in the preceding period.

Q. Next item.

A. Next item, shipping expense in which there is no change.

Q. Now, with the addition of the items that you have thought should be includable, it would show an increase over those two years of 29 cents, would it? A. That is correct.

Q. The increase of the second year, 1943, over the previous year, 1942, would be 29 cents and then there is the item interdepartmental water, 1 cent, and insurance, 1 cent. A. Yes.

Q. And they should be included without discussion of it further [541] and the other things, the further facts which you mentioned. A. True.

Q. Will you quickly turn to Exhibit F of the plaintiff's interrogatories, which is already in evidence.

Mr. Rosenberg: I will submit this was gone into on direct examination and it is being re-asked only for the purpose of making a display on the black-board, I assume.

Mr. Bennett: Well, I thought it would be of aid to the Court.

The Court: If it was gone into, you have a record.

Mr. Bennett: It has not been gone into with specific reference to the figures. It is conceivable on the argument we could spell it out, but there may be a dispute about the facts. I thought we

(Testimony of Paul K. Webster.)

could have them definitely determined by the witness' testimony.

The Court: Well, I think we are going over this testimony unnecessarily. We have every figure here that has been developed so far.

Mr. Bennett: Well, all right, Your Honor, if you don't wish—the second period has to do with the third price increase. I thought the witness' testimony would be specific.

The Court: I am sure you gentlemen, neither of you, will overlook anything.

Q. (Mr. Bennett): Mr. Webster, in dealing with the accounting methods to be applied in any particular situation, wherein [542] the conditions might vary, state whether or not in the determination of the method of accounting whether there are certain underlying, well established accounting principles that should be applied.

A. Well, yes, it seems to me whether there are accounting principles or not, there are certain standards that should be applied. In this type of a problem accounting should be considered as a tool of management; one of the basic functions of accounting is to furnish management with information from which management can make important decisions. If a decision to be made by management is whether to save and sell a product which would otherwise be waste or to discard it at some stage in the process, then it seems to me that information should be developed from the accounting system to indicate the cost of saving and selling that

(Testimony of Paul K. Webster.)

material as against the cost of discarding it at some point.

Also, it seems to me where you have a contract between two parties relating to the furnishing of a product that where the cost of that product is an important element in the contract, that the selling party, the producing party is under a certain obligation to include in his cost only the costs that specifically relate to the production of that product and not unrelated costs, and that in the fourth place, where an increase or decrease in the cost of a product is an important factor, that it is highly important that the same method of accounting be followed in both periods which are under consideration in order that you may here show increase or decrease resulting from a change in the method of accounting rather than from a change in actual cost production.

Q. Directing your attention to the chart which is Plaintiff's Exhibit for identification 16, assuming that in the manufacture of the primary product from which product it is necessary to remove an impurity or a substance the removal of which is necessary to produce the primary product and that substance removed is the thing that is further processed for sale; state whether or not, in your opinion, that would constitute a by-product or a co-product.

Mr. Rosenberg: I object to that on the ground it is assuming something not in evidence and it is not proper cross examination and it assumes a

(Testimony of Paul K. Webster.)

fact—if you want him to assume that there is a primary product, tell him what it is. What is the primary product?

Mr. Bennett: I thought I could do that the other way.

Q. Assuming, Mr. Webster, that the primary product in the manufacture is magnesium oxide, that the initial base material which is to be used is bittern which has already been described to you here, and assuming that to the end that in the manufacture of this primary product, magnesium oxide, it is necessary to remove the sulphate from the magnesia or other chemical [544] compounds which otherwise would preclude the manufacture of the primary product if it were not removed from the base liquor and that that product which is removed is for purpose of sale further processed by drying and grinding and delivering to the cars, whether you would consider that product which is removed, and subsequently further processed, a main product or a by-product?

A. It would appear to me to meet the definition of a by-product.

The Court: That five minutes is now nearly twenty minutes.

Mr. Bennett: I think that I am about through. There are several other matters. Thank you, Your Honor.

The Court: Now, you wish to ask some questions.

Mr. Rosenberg: I have one or two questions.

(Testimony of Paul K. Webster.)

Recross Examination

Q. (Mr. Rosenberg): These conclusions you gave with reference to Exhibit E are based upon the assumptions and the opinions that were expressed in your direct examination?

A. That is correct.

Q. With reference to the depreciation, I believe you have testified that keeping books of account on a straight line basis for depreciation, you can not say is not good accounting practice, but you think that for the purpose of this contract it would be better to keep it on the basis you said?

A. That's right. That is correct.

Q. In arriving at your conclusion as to which is a byproduct you were asked to assume that what is taken out is an impurity. I presume that would affect your conclusion——

A. Not necessarily. Whether it was an impurity or something taken out as an incident to providing for another product wouldn't make any great difference.

Q. We are dealing with chemicals now. Assuming that to get the product which is gypsum you have to add something to join up with the sulphate in the bittern water to make the gypsum that is to be processed, would that affect your conclusion?

A. That would depend on whether that addition were for the purpose of removing a substance from the main product or for the purpose specifically of producing the byproduct.

Q. Maybe we can get it this way: I will ask you something that you answered on cross-examination;

(Testimony of Paul K. Webster.)

before you, as an expert public accountant, would undertake to determine for accounting purposes whether this product should be treated as a by-product or a main product, you would require a great deal more detailed information than you possess at this time, isn't that correct?

A. Oh, yes. My information is rather limited for the whole problem.

Q. You would have to have more information than that assumed in the question which Mr. Bennett put to you?

A. Yes, except the question that he put me rather definitely, [546] comes within the line of the byproduct.

Q. But there should be more in consideration that would alter your opinion?

A. It is possible.

Mr. Rosenberg: That is all.

Mr. Bennett: I want to thank Your Honor very much for your indulgence.

(Thereupon an adjournment was taken until 2:00 o'clock p.m.) [547]

Wednesday, December 17, 1947, 2:00 P.M.

The Court: You may proceed.

Mr. Bennett: Will you take the stand, Mr. Flick?

C. BRUCE FLICK

resumed the stand, previously sworn.

Mr. Bennett: I am proceeding now, Your Honor, with the redirect examination of Mr. Flick, which

(Testimony of C. Bruce Flick.)

was interrupted by Your Honor's indulgence to permit the calling of Mr. Webster out of order.

Redirect Examination

By Mr. Bennett:

Q. Mr. Flick, I show you herewith plaintiff's Exhibit No. 18 and direct your attention to the headings on the several sheets that appear on that exhibit and the segregation of particular items of cost or alleged costs and ask upon what basis, if any, those headings and the classifications were made by you.

A. I have previously testified that I wrote in these headings and account titles on the original schedules, of which this is a photostat and I took those headings and account titles from the headings and account titles furnished to me by Westvaco.

Q. Were these items or segregations of the items of cost or alleged costs grouped pursuant to your own interpretation or by reason of any grouping or classification made by the [548] defendant itself?

A. The grouping follows Westvaco's groupings and subtotals for groups I think you will find checks with the subtotals or group totals in the answers to the interrogatories.

Q. The actual figures written in, other than the calendar years at the top of the column, were figures that were written in, so far as you know, by the defendant or some agent of the defendant?

A. Yes.

(Testimony of C. Bruce Flick.)

Q. This explanatory note on page 3 entitled "Westvaco, Charges Per Books to Costs of Production of Gypsum, Overhead and General Plant Expense," that was affixed on there after you delivered the outline, the form to the defendant and prior to the receipt of the document filled in?

A. That is correct. I did not affix that explanatory note.

Q. And you assume that that was affixed by the defendant? A. Yes.

Q. I notice that in certain of these pages there is written in in pencil certain additional items under certain of the so-called title groupings. Was that written in or did it appear on the form that you submitted to the defendant at the time you submitted the form or did it appear afterwards and at the time you received it back from the defendant?

A. Well, those additional account titles or captions were filled in after I had filled in the original headings. The [549] handwriting is quite clearly distinguishable.

Q. Well, the dark handwriting, or that which appears to be in ink was written in by whom?

A. Written in by me. That is the majority of these account captions.

Q. The form that was submitted to the defendant contained these items that were written in in ink that you have described? A. Yes.

Q. The ones written in in pencil were not writ-

(Testimony of C. Bruce Flick.)

ten by you nor do they appear on the form as you submitted it to the defendant?

A. That is correct.

Mr. Bennett: I take it, counsel, that we can stipulate that those items were added to the form under the titles by the defendant, can we not?

Mr. Rosenberg: I am sure that is true, but I will say again for the purpose of the record I am not stipulating as to anything regarding a document that is not in evidence.

Mr. Bennett: Well, this is in evidence, counsel.

Mr. Rosenberg: I thought you put it in for the purpose of showing one item in there.

Mr. Bennett: No, I put it in for the purpose of showing, as I explained, the claim of the defendant for the amounts alleged or claimed by the defendant of the costs for these periods shown in the summary, these annual periods, and only for that purpose. [550]

The Court: Very well.

Q. (By Mr. Bennett): State whether or not from the classifications given to you by the defendant and upon which you filled out this form the items of taxes, insurance and depreciation were classed or listed by the defendant under the title or classification as overhead.

Mr. Rosenberg: What forms are you talking about now?

Mr. Bennett: The witness has testified all these groupings, the form he made out for you to fill in, was made out with certain classifications which he

(Testimony of C. Bruce Flick.)

followed from classifications which you had previously given.

Mr. Rosenberg: When and by whom? I would like to know that, Mr. Bennett.

Mr. Bennett: We can develop that.

Mr. Rosenberg: I think the record shows, if the Court please, we have in evidence at this time a statement of the production costs for the period from July 1, 1939, to June 30, 1940, and July 1, 1940, to June 30, 1941, furnished by the defendant to the plaintiff, and the same thing for the calendar years 1942 and 1943, and the same thing from the period July 1, 1944, to June 30, 1945, and from July 1, 1945, to June 30, 1946, and all of those sheets are in evidence, and I submit that they will show the form in which we submitted our figures to the plaintiff. I do not think it requires any oral testimony at all. [551]

Mr. Bennett: If that is so, what harm could there be in this witness getting the matter clear and succinct before the Court now?

The Court: That is the second time counsel has indicated that that is in the record. Yesterday he repeated the same language.

Mr. Bennett: It is true we can take the record and spell out to Your Honor an answer to this question, but it would seem to me it would facilitate an orderly understanding of the point later to be made here to have this witness, now dealing with a new document which has not been discussed yet except as a preliminary basis for a question

(Testimony of C. Bruce Flick.)

to the preceding witness, to show (a fact that I intended to show) that this document, Plaintiff's Exhibit 18, was made out, so far as the classifications of items appearing on the form, pursuant to the classifications previously given by the defendant, and my purpose was to show that the defendant at all times has treated taxes, insurance and depreciation, not under the title of overhead, but as a separate item.

Mr. Rosenberg: I will stipulate to that.

Mr. Bennett: Thank you, counsel.

Q. Reference was made, Mr. Flick, during your cross-examination to a transaction that you had with Permanente Cement Company wherein certain of this gypsum purchased from the defendant was sold by you to Permanente. When was that arrangement [552] first made?

A. The arrangement to sell the gypsum to Permanente was first made by Pacific with Permanente after the construction of the Permanente Cement plant, which was in 1940, and this contract with Westvaco was made, first, January 29, 1937, so that in the first few years of this contract we had no arrangement with Permanente.

Q. Is the contract with Permanente still in force and effect or has that ended?

A. It expired and it is not in force and effect any longer.

Q. Are you selling gypsum to Permanente?

A. No, we are not selling gypsum to Permanente.

(Testimony of C. Bruce Flick.)

Q. In that connection, to clear up one matter, you stated, as I understood, the price you charged for gypsum at the Gerlach plant was what?

A. I think I mentioned a price for gypsum for cement retarder at our Gerlach plant at the present time as \$3.50 per ton loaded bulk on board cars at our Gerlach plant.

Q. If that product was sold from the Gerlach plant for delivery into the San Francisco Bay Area, there would be added to the base price the freight?

A. The buyer, wherever he may be located, would pay the freight from Gerlach to his destination.

Q. Do you know what the freight rate is from Gerlach to San Francisco Bay Area for Gypsum per ton? [553]

A. I do not know precisely. I think it is in the neighborhood of perhaps \$3.80 a ton.

Q. During your cross-examination the question was asked whether or not the building of facilities in the manufacture of the byproduct would have any effect in your mind in answers given. I will ask whether in your opinion as a expert public accountant, the building of facilities in the manufacture of the byproduct, would have any effect in your mind in answers given. I will ask whether in your opinion as an expert public accountant the building of facilities in the nature of additional buildings, if necessary, and additional machinery for the processing of the byproduct itself, and not related to the production of the main prod-

(Testimony of C. Bruce Flick.)

uct, would, in your opinion, alter or, for that matter, influence the question or determination of whether that product produced in that additional plant of facilities was or was not a byproduct.

Mr. Rosenberg: Mr. Bennett, your question carries with it the assumption that it is a plant to process a byproduct. You are asking him whether or not the fact that you have a plant to process what you have already classed a byproduct changes the character of the product?

Mr. Bennett: Maybe that objection is good, counsel. It is an awkward question, in any event. I will try to state it another way and quickly:

Q. Would the building of additional facilities, such as a shed [554] or plant, and the additional machinery for the processing of a product in and of itself, affect, in your opinion, whether or not that product was a co-product or a main product or a byproduct?

Mr. Rosenberg: To which I will object on the ground it has been asked and answered. It is not proper redirect and it is an attempt to impeach the witness. The witness stated on direct examination and on cross-examination that one of the considerations that would influence his determination as to whether a product is a byproduct or a joint product is the purpose for which the plant was constructed. Now, the purpose of this question, I guess, is to change that testimony. If it is, I submit it is improper as an attempt to impeach plaintiff's own witness.

(Testimony of C. Bruce Flick.)

Mr. Bennett: No.

The Court: I will allow the question subject to your motion to strike and over your objection. You may answer.

The Witness: Well, the consideration whether a plant was built to take care of the contemplated processing of a byproduct or whether a plant might subsequently add equipment for the purpose of processing a byproduct does not in itself alter the character of the byproduct as a byproduct. The essential nature of a byproduct, as I have tried to testify, is in my thinking the processing of a material which might otherwise be a waste material or something which is produced incidental to [555] a primary product, and that holds no matter whether the plant might be originally laid out to take care of that processing or whether at some later time it might be decided to add some equipment to process the byproduct.

Q. (By Mr. Bennett): If the plant was built for the purpose of producing a primary product or a main product, was the fact that facilities were also added for the manufacture of a byproduct influence or have any effect on your determination that such byproduct was in fact a byproduct?

A. I do not think so. I think that whether a product is a byproduct, according to the definition of byproduct that I have expressed, depends on the nature of the product and its relationship to the primary product and not merely on whether the plant was built in contemplation of having the

(Testimony of C. Bruce Flick.)

byproduct processed or whether some equipment might be added at some later time.

Q. Now, in a situation, Mr. Flick, where in the process of the operation of your plant no costs for processing are charged against a certain product up to the point of separation of that product from the other products, according to your understanding of accounting principles, would that be, up to that point, an indication of whether the accounting was for a byproduct or a co- or a main product?

A. Well, I have testified that in byproduct accounting principles, No. 1 is that if it is a byproduct which requires [556] processing to give it market value, that the first principle is that you do not assign as part of the cost of manufacture of the byproduct anything prior to the point when the byproduct is separated out or split off from the main product, and that you then assign only those out-of-pocket costs to put that material into marketable condition after it has been split off or separated from the main product, so that therefore it follows as a corollary that if the accounting did not charge anything to this cost of manufacture of the byproduct prior to the point of separation, why, that would appear on the face of it to me to reflect the position that the product were a byproduct.

Q. (By the Court): Where would you say the point of separation was here?

A. As I view the case of this byproduct, gypsum, the gypsum is not separated until it is filtered

(Testimony of C. Bruce Flick.)

out and the filtered cakes, the solids which are filtered out, are dried and ground and become this commercial gypsum.

Q. What has gone on before is divorced entirely away?

A. That is divorced entirely away. The liquid from the filter contains the magnesium chloride and goes on to the major product, the primary product of production.

Mr. Bennett: In this case, counsel for the defendant has stated that up to this point of separation of this filter cake, no processing charges are made by the defendant against the product gypsum, no direct charges. [557]

Q That would be consistent, at least so far as it goes, with your theory of cost accounting for a byproduct, would it not?

A. Yes. If no charges are made prior to the point of separation, that is consistent with what I have stated to be good accounting for a byproduct.

Q. Assuming that this calcium sulphate, which is precipitated out of the fluid at a point in the process, and which is later dried, ground and delivered, was a co-product, what would be the accounting procedure for direct charges up to the point of separation?

A. Well, in accounting for co-products or joint products, it is customary to charge all of the costs to the different joint products. For example, we have used as an example our Gerlach, Nevada,

(Testimony of C. Bruce Flick.)

plant, where we make, let us say, four products from the gypsum rock that comes down from the quarry. Now, the rock and all of the costs are charged to those four joint products.

(At this point the grand jury reported to the Court.)

Q. (By Mr. Bennett): Going back for a moment to the chart, Plaintiff's Exhibit for identification No. 16, as I understood, Mr. Flick, to the bittern water is added the calcium chloride; is that your understanding of this process?

A. Yes.

Q. One of the first steps before the filter cake or the gypsum is taken off? A. Yes. [558]

Q. We might say that we start here with not only the bittern as a base material, but the calcium chloride, which is added, is that correct?

A. That is correct.

Q. In your discussions with Mr. Williams or Wallace of the defendant, were you given to understand, was the matter explained to you as to why this calcium chloride was added to the bittern water? A. As to why?

Q. Yes.

A. I do not remember a specific discussion with Mr. Williams and Mr. Wallace. I believe that Mr. Wallace, in a general way, explained the processes at the time I was at the plant, and these chemical reactions have been quite widely publicized. It is common knowledge. They start with the bittern water because it has got the magne-

(Testimony of C. Bruce Flick.)

sium sulphate in it and they have got to convert that into a form which is usable to get magnesium oxide eventually, and in order to do that the calcium chloride is added. Now, that is for two purposes, really, as I understand those chemical reactions. The first purpose is to break up that magnesium sulphate combination. That is what happens when you add calcium chloride. They both break up, and then they recombine chemically so that you get magnesium chloride, which can then be carried along for the further processing to eventually get magnesium oxide, and you also [559] accomplish the removal because the calcium combines with the sulphates in the bittern—you accomplish the removal of the sulphate, which would be, as I understand, an impurity if it were allowed to remain in. You have got to get rid of the sulphates before you can proceed to get your primary product.

Q. Magnesium oxide?

A. Magnesium oxide. [559-A]

If I might add a little bit to that with specific reference to the two weeks in September, 1946, when Westvaco did not dry and grind the gypsum but dumped the material into the Bay, my understanding is that they proceeded with the same filtering and process and they did not change the process at that time other than that they simply dumped the filter cake.

Q. Now, in the operation of your Gerlach plant, when you say you manufacture only main or co-

(Testimony of C. Bruce Flick.)

products, if you stop the production of one of your main products, such as gypsum board, would there be any waste or dumping of any of the material that you had previously manufactured?

A. No. You have at Gerlach no problem at all of a waste or of a material which you have to remove for a byproduct or anything of that character. You bring down from the quarry your pure gypsum rock. Then you can make any of these four products from it.

Q. If you stopped one, then that raw product goes into the other; is that correct?

A. Yes.

Q. As I understand it, Mr. Flick, up until January 29, 1944,—this is preliminary, Your Honor,—you did not know or understand that the defendant had claimed in so far as the first increase of 18 cents that any part of that 18 cents involved anything other than direct charges; is that correct?

A. That is correct. Until January, 1944, I had no knowledge [560] that the original 18 cent increase was based on anything other than direct charges.

Q. And that the only information you had in your file was this letter of October 2, 1941, which is Plaintiff's Exhibit 1, which has already been in evidence and which listed—the letter from Mr. Hurlburt, the chief accountant, Westvaco Chlorine Products Corporation, that listed or stated, "We are attaching hereto an increase of labor, material and power cost which amounts to 15 cents per ton

(Testimony of C. Bruce Flick.)

of the 18 cent per ton increase of which you have been previously notified''; up to that time was there anything else in the file or had you been told by anyone either from Westvaco or your own company that any part of that 18 cents was for the direct charges as distinguished from indirect charges? A. No.

Q. What was your understanding up until the time you received this letter of January 29, 1944, Defendant's Exhibit A for identification, as to what the charges involved in that 18 cent increase were?

A. I understood they were direct charges. Mr. Hurlburt's letter set out three items that were, that made up 15 cents of the 18 cents and I understood the other three cents was direct charges but too minor to set up in detail.

Q. (By the Court): You discussed these matters orally before or after this letter? [561]

A. Orally with whom, Your Honor?

The Court: Who?

A. Mr. Canvin.

The Court: Yes.

A. Yes, with Mr. Canvin. Mr. Canvin died on June 3, 1944, so I did discuss with him and he accompanied me on my first visit to Westvaco in January, 1944.

Q. (By Mr. Bennett): Was anything said?

Mr. Rosenberg: Just a moment. Your Honor understands Mr. Canvin was in the employ of Pacific Portland Cement Company, not Westvaco.

The Court: I understand.

(Testimony of C. Bruce Flick.)

Mr. Rosenberg: I object to any——

The Court: Self-serving declarations?

Mr. Bennett: I don't think it would be in this case, because it was at——

The Court: How could they be bound by any oral discussions between themselves?

Mr. Bennett: Well, they are contending that we had knowledge, I assume, prior to 1944, that this 18 cents, the first increase was based upon indirect as well as direct charges and that by our subsequently paying that increase that we are in some way estopped from questioning the matter.

The Court: I might have confused you in my question. Did you discuss the subject matter of this letter before or [562] after with any of the defendants? I want to get straightened out on the testimony.

The Witness: My discussions with the defendant Westvaco were only from January, 1944, and thereafter. This letter of 1941, that is the one from Mr. Hurlburt——

Mr. Bennett: Yes.

A. To Mr. Canvin—that was written——

The Court: That is what I wanted to follow, the testimony there.

Mr. Bennett: I wish Your Honor would interrupt whenever you wish. Is there any question in Your Honor's mind about this short letter of October 2, 1941?

The Court: I was confused. I thought it was 1944.

(Testimony of C. Bruce Flick.)

Mr. Bennett: No. I would like to read this again in view of the confusion.

The Court: That occurred in 1944, what we have been discussing.

The Witness: Before January, 1944. In January, 1944, I made my first trip to Westvaco to look at their operations.

The Court: Yes; I got confused on the date only.

Q. (By Mr. Bennett): Up to that time no one either in your employ or connected with the defendant had ever advised you that any part of this 18 cent involved direct charges or other than direct charges? A. No. [563]

Q. When was the first time that you had any knowledge or information that any part of that 18 cent increase, the first increase that was asked for by the defendant in 1941, contained any element of indirect charges?

A. Well, that was after my visit to Newark on January 14, 1944. I later wrote a letter to Mr. Wallace or Mr. Cuneo. Mr. Cuneo replied and I don't recall the date, but it was later, I believe, in January, and gave me the same breakdown or classification of figures the 1940 and 1941 periods that I had just obtained from them for 1942 and '43. I was concerned primarily then with 1942 and '43 because they were then claiming a price advance of 78 cents a ton, so I became interested to see what they had charged in the earlier period in order to see whether there had been significant

(Testimony of C. Bruce Flick.)

changes in accounting classifications or what they might call changes in accounting practices. So I asked for the figures for the earlier 1940-'41 period which Mr. Canvin did not have in his file. He had in his file only this 1941 letter from Mr. Hurlburt.

Q. You mean Plaintiff's Exhibit 1. The letter you refer to from Cuneo is Defendant's Exhibit A for identification, the letter dated January 29, 1944, is it not?

Mr. Rosenberg: That is not A for identification.

Mr. Bennett: Well, it has the words "for identification."

The Clerk: It is in evidence.

The Witness: A. Yes, this is the letter I referred to, [564] Cuneo's letter of January 29, 1944, in answer to mine of January 18th.

Q. (By Mr. Bennett): That letter advised you for the first time, as I understand it, that there were indirect charges involved in that first increase back in 1941 of 18 cents; is that correct?

A. I don't know that I understand—you said indirect charges involving 18 cents. The entire amount of increase was 18 cents.

Q. Yes.

A. And that included indirect charges as well as direct charges.

Q. That letter advised you for the first time that it included indirect charges? A. Yes.

Q. Up to that time you did not know that fact?

(Testimony of C. Bruce Flick.)

A. That is correct.

Q. Why was it, if there was any reason for your continuing to pay that price of \$2.98 after you received the letter of January 29, 1944, from Mr. Cuneo?

A. Well, there were several reasons why we continued to pay the price of \$2.98. OPA price regulations had gone into effect by that time, and at that time the maximum price or ceiling price that could be charged was \$2.98.

Q. Had you been paying that \$2.98 up until that time from 1941? [565]

A. The contract began at \$2.80. The first increase was the 1941 increase of 18 cents which, as I recall it, was effective October 5, 1941, and since that time we have been paying \$2.98. The base month under OPA regulations was generally March, 1942, so the price was then frozen at \$2.98.

When we came to the first part of 1944 after I made by review of the figures,—you will recall that the original contract price was \$2.80, which was for the direct charges, the figures which Westvaco furnished me showed that on that first price increase of 18 cents 9 cents was for direct charges and that would have made the price \$2.89, if we just take the direct charge increase, and then the second claimed price increase for 1943 compared to 1942, the direct charges increased 29 cents, so that would have made the price \$2.89 plus 29, \$3.18, so that we were quite willing to pay based on direct charges that price which was then in excess of the

(Testimony of C. Bruce Flick.)

OPA ceiling price. That was one of the reasons why we did not feel that it would be fair or proper to try to go back under any circumstances to get a reduction in the \$2.98 price. Another reason why was that at the time the Westvaco people were claiming 78 cents increase, and wanted to file an application with the OPA for permission to charge \$3.76 and they were asking us to join with **them** in that application and threatening the discontinuance of the production of gypsum which we did not wish them to discontinue at that time due to our commitments and uses and, of course, [566] after I made my January review we almost immediately, I think, on February 4, perhaps, wrote a letter to Westvaco in which we stated our position on all of these accounting questions and under all the circumstances we acquiesced in the \$2.98 price. We did not agree with the accounting bases on which it had been computed but under these circumstances that I have mentioned we acquiesced in the price as a separate and distinct question from the other accounting bases. As I say, we made our position clear on the accounting problems, accounting questions involved. With that OPA ceiling price of \$2.98 we acquiesced in it, we paid the \$2.98 as I have testified, down until September 4, 1946.

Q. Now, from that time on up until the filing of this suit, this action we are trying now, did the defendant or any of its representatives or agents ever say or contend that you had ever by

(Testimony of C. Bruce Flick.)

paying the \$2.98 price, recognized the propriety of including in the cost of production or the cost of manufacture of gypsum indirect as well as direct charges?

A. No, they never said any such thing to me. All discussions and debates on which should be charged and should not be charged were always on the merits of the question and their insistence on their uniform national accounting system; they never made any such statement or point to me that we could not question the accounting costs by anything that had gone before.

Q. When is the first time that any such position was ever [567] called to your attention?

A. The first time it was ever called to my attention was in their answer after the suit was filed.

The Court: Have you concluded with this witness?

Mr. Bennett: Well, I am almost through, Your Honor; I am sorry.

Q. Mr. Flick, during your cross-examination counsel asked you with reference to certain figures that were on the board that I had placed there relating to the amount of deductions that were made from time to time by Pacific from the price paid because of the failure of gypsum content to measure up to the specifications provided for in the contract. Are you prepared at this time to state for the year 1942 the average per ton deduc-

(Testimony of C. Bruce Flick.)

tions that were made by your company for gypsum because of the substandard quality?

A. Yes, I have the figures.

Q. What was it in 1942?

Mr. Rosenberg: Just a moment. I object to that on the ground it is incompetent, irrelevant and immaterial. Let me explain this to the Court. This witness testified that in the early part of 1944 when he offered to pay \$3.29 a ton when according to our books, we were entitled to \$3.76 that Mr. Wallace said we could not sell it at price at a profit and then Mr. Bennett purported to put on the board what we would have made, the profit of 56 cents a ton we would have made had [568] we sold them the gypsum at \$3.29 at that time, in 1944. Let's see what they tell us of their credit deductions made during 1944, during 1945 and during 1946. These people were talking prospectively or backwards. If you want to develop 1944, 1945 and 1946, I have no objection.

Mr. Bennett: All right. We will do that, then. 1944, when did they tell you, when did Mr. Wallace or Mr. Williams say they had shut down their plant because they could not make any profit?

Mr. Rosenberg: Just a minute. The witness never said anything of the sort.

Mr. Bennett: Well, I will withdraw that question. There is testimony by the witness and you cross-examined him to some considerable extent with reference to a statement by Mr. Williams with reference to shutting down the gypsum production

(Testimony of C. Bruce Flick.)

because of the inability to make a profit. Do you dispute there is evidence about that fact?

Mr. Rosenberg: No. You said that they shut down the plant.

Mr. Bennett: I was mistaken in that connection, Mr. Rosenberg.

The Witness: As I recall it, it was in March, possibly in April, 1944, when Dr. Seaton, I believe, wrote a letter stating that they definitely would discontinue gypsum production on March 15 if we did not go along with them in the [569] application to OPA and if we did not give them a raise and would not pass on that price increase to our own customers in reselling the gypsum, and it was about that time when Mr. Wallace and Mr. Williams said that they would discontinue the production of gypsum because they said, "We can't operate this gypsum production at a loss."

Q. Now, for the year 1944, what was the average per ton deduction because of substandard gypsum or for any other cause?

A. For the period 1944 the deductions which we made—do you wish me to give the tons and the total——

Q. Per ton. A. Just per ton?

Q. Yes.

A. The deduction per ton, and this is after \$263.69 corrections which were included in this recent statement we have discussed before, the deductions amounted to four and a half cents a ton.

Q. Four and a half cents a ton.

(Testimony of C. Bruce Flick.)

Getting back, the cost given in the last period was \$1.00 plus shipping cost of how much?

A. Including the allocated shipping cost for the year 1943, their figure shows \$1.00 for direct charges and 19 cents for shipping expense.

Q. At the time of this discussion with Mr. Wallace and Mr. Williams and the letter from Dr. Sea-ton, you did not have the 1944 cost, did you? [570]

A. Why, no, because the time was then in March, 1944.

Q. What are the direct costs given in the figure that you have now?

Mr. Rosenberg: If the Court please, I submit this has all been gone into. This is merely an attempt to hit and hit and hit the same thing over again.

Mr. Bennett: I think counsel went into this at considerable length on cross-examination to show these figures were wrong. On redirect examination I think I can show they are not wrong, that there is only a deduction of four and one-half cents from the total price plaintiff was willing to pay. Plaintiff was willing to pay \$3.27 a ton. As I said before, the cost of production of the gypsum amounted to \$1.19 including this item of shipping and both direct and indirect charges. Now, the deductions come from the price we were willing to pay them and I show it was \$2.08 profit that they had made and they wouldn't make it if they shut the gypsum plant down. Counsel went in on cross-examination to show this is not a cor-

(Testimony of C. Bruce Flick.)

rect figure or figures, because there were deductions on account of substandard gypsum. I have shown to the witness that there was four and one-half cents per ton deducted for 1944, that would leave \$2.03 and one-half cents per ton still realizable as profit.

Mr. Rosenberg: Are you trying to tell us, Mr. Bennett, and tell the Court this is what you had on the blackboard? [571] Didn't you have \$3.27 and you said assume the correctness of that cost figure which was \$2.71——

Mr. Bennett: Well, I am coming to that, counsel. That is the next step here.

Mr. Rosenberg: You are saying this is what you had on the board. You did not have anything of that kind on the board.

Mr. Bennett: I had them and I had something like——

The Court: Well, in order to get straightened out, gentlemen, we will take a recess. [572]

Q. (By Mr. Bennett): As I understand, Mr. Flick, the price you were willing to pay was \$3.27 after they had asked for this second price raise?

A. Yes.

Q. And the total claimed cost of production that the defendant asserted, including indirect as well as direct cost, amounted to \$2.71, didn't it?

A. Yes, that was their total cost for the year 1943 as shown on their books.

Q. Which arithmetic leaves us the sum of 56 cents; deducting from that the 4½ cents deduction

(Testimony of C. Bruce Flick.)

that you made per ton in 1944 for gypsum being substandard would leave $51\frac{1}{2}$ cents profit, would it not? A. Gross profit.

Q. I hand you herewith two letters, and attached statements, both dated October 31, 1946, addressed to Pacific Portland Cement Company, and purporting to be signed by Westvaco Chlorine Products Corporation, O. D. Watt, Office Manager, and ask you whether you received the originals of those documents on or shortly after the date written? A. Yes.

Mr. Bennett: These are matters which are not in evidence. I offer these two letters in evidence, to be marked separately the next two exhibits in order.

The Court: They may be admitted and marked.

(The documents in question were thereupon received in evidence and marked, respectively, Plaintiff's Exhibits 19 and 20.)

Mr. Bennett: Exhibit 19, your Honor, is a memorandum of October 31, 1946. The letter attached reads as follows:

“Pacific Portland Cement Company
417 Montgomery Street,
San Francisco 6, California,

Attention: Mr. C. B. Flick, Vice President

Gentlemen:

We are attaching our statement in the amount of \$514.91 covering gypsum specification charge-

(Testimony of C. Bruce Flick.)

back deductions, for period 12/31/40 to 9/8/44, that you have made from our invoices that are not authorized by the terms of the agreement dated January 29, 1937."

And the attached statement shows under date 10/31/46, "Gypsum specifications charge-backs from 12/31/40 to 9/8/44.

"Pacific Portland Interpretation. \$2,599.09

Westvaco Interpretation 2,084.18

\$514.91"

The second letter, Exhibit 20, states:

"We are attaching our statement in the amount of \$8,457.62 covering gypsum specification charge-back deductions for period 10/10/44 to August, 1946.

"We assert that these deductions which you have made [574] from our invoices are not authorized with respect to shipments of gypsum made after September 8, 1944, by the express terms of the agreements dated September 8, 1944, and July 25, 1945."

And the attached statement, omitting the address, and so forth, reads:

"10/21/46 Gypsum specifications charge - backs from 10/19/44 to August, 1946, \$8,457.62."

Q. I will ask you if at any time, Mr. Flick, the defendant or anyone connected with the defendant called to your attention any objection specifically to deductions which you had made with-

(Testimony of C. Bruce Flick.)

out allowing the 2 per cent tolerance which you have testified was later discovered by you when you had the matter investigated?

A. No, they did not call my attention to the fact of any failure to give that 2 per cent tolerance allowance. I think I testified before that at the time they asserted these claims in 1946, which were a surprise to me because they had not asserted them during 1944 or 1945, I asked Mr. Wallace to give me detail and show me what was wrong with our deductions and I would be quite willing to check it and if we were wrong in any respect to make it right.

Q. I next direct your attention to Defendant's Exhibit E, which is a letter of September 23, 1946, which was in reply to your letters dated September 13, 1946, which were plaintiff's exhibits 11 and 12, respectively. Contained on page [575] 2 of Defendant's Exhibit E is the following statement at the bottom of the page:

"In answer to the above-entitled paragraph in your letter, we agree with you that in any calendar year in which you do not exercise your right to refuse to purchase and accept in excess of 20,000 tons of our gypsum production for the succeeding calendar year, that you are bound to purchase our entire production of gypsum deliverable to you in such year when offered to you in approximately equal monthly installments."

Did you ever make any such agreement to that effect?

(Testimony of C. Bruce Flick.)

A. We did not. I might say this, that the first letter which I wrote, dated September 13, 1946, was the longer of the two letters.

Q. That was Exhibit No. 11.

A. And after I sent that to Mr. Wallace we discussed it by telephone and I then wrote the second of the two letters dated September 13, 1946, which is the shorter of the two letters. Both letters were dated September 13th, but the first or longer letter was actually delivered or mailed September 13th. The second or shorter letter was actually delivered or mailed I think it was September 16th, and I was very much surprised when I received this letter of September 23, 1946, in reply, which referred to both of those letters dated September 13th, whereas one was intended to supersede the other, and I was [576] quite sure Mr. Wallace had so understood it. We did not make any such agreement as expressed in what you have just read.

Mr. Rosenberg: Mr. Bennett, if it would save any time, I am willing to stipulate that Mr. Flick wrote a letter denying the interpretation which you read on that 20,000 tons.

Mr. Bennett: To the effect that any agreement had been made.

Mr. Rosenberg: Yes, and my recollection is Pacific wrote a letter reiterating its position and then Westvaco wrote a letter reiterating its position, and that went on for some considerable time until somebody had the good judgment of saying, "There

(Testimony of C. Bruce Flick.)

is no use in our continuing to write letters asserting our respective positions.”

Q. That is about right, isn't it?

A. In general, that is about what happened.

Mr. Bennett: Thank you, Counsel. That will save considerable time.

The Court: You have consumed 12 minutes of that one minute you requested.

Mr. Bennett: That one minute, your Honor, referred to my examination concerning the chalk talk.

The Court: I think you have covered the matter.

Mr. Bennett: You may recross-examine, if you have any recross-examination.

Recross-examination

By Mr. Rosenberg:

Q. Mr. Flick, as I understand your testimony [577] now, you state that in view of the fact that in keeping its cost records with reference to gypsum Westvaco does not charge any processing prior to the point of separation, that you take that to be an admission by Westvaco that gypsum is for accounting purposes a byproduct, is that right, an indication?

A. Well, I do not think that I said that it was an admission by Westvaco. I said that one of the characteristic features of by-product accounting is that you do not charge anything prior to the point of separation, and therefore if you have a situation where the company involved is not charging anything prior to the point of separation, why, on

(Testimony of C. Bruce Flick.)

the face of it it looks to me as if that is in accordance with by-product accounting rather than joint product accounting.

Q. And by the same token would you say that the fact that Westvaco charges bittern, part of the raw material, to gypsum, would lead by parity of reasoning to the conclusion that Westvaco was treating it as a co-product or a joint product, is that right?

A. Yes. Westvaco had told me repeatedly that in their uniform accounting system they treat everything as if it were a joint product or a co-product.

Q. And according to your views it is improper to include in cost of production of a by-product any overhead charge, isn't it?

A. You would not include in the cost of production of a by-product [578] any charge which you would have if you discontinued the production of the by-product or which you would have in a lesser but unascertainable amount.

Q. So, if any conclusion is warranted from the method employed by Westvaco in keeping its cost accounts related to gypsum, the fact that it does include in the cost of production of gypsum overhead expense which would continue notwithstanding the production of gypsum, if you are going to draw any deduction from that, it would indicate that Westvaco, for accounting purposes, has been treating gypsum as a co-product, wouldn't it?

A. I think so. The Westvaco have repeatedly told me that they treat all products as joint prod-

(Testimony of C. Bruce Flick.)

ucts for accounting purposes, no matter whether they are by-products or not.

Q. When you visited the plant in 1944 Westvaco was making bromine, wasn't it?

A. I believe so.

Q. At that time were you informed that none of the processing in relation to the recovery of bromine is charged to magnesia? Were you informed of that fact?

A. I was not informed as to what was charged to bromine or what was charged to magnesia.

Q. I believe you repeated on redirect examination that one of the circumstances that influences your conclusion that gypsum is a by-product is that the sulphate is an impurity which must [579] be removed for the purpose of making magnesium oxide, is that right?

A. That is correct.

Q. Will you tell me this: If the magnesium were not removed from the calcium sulphate, then to the extent of the magnesium that you have in there, and conceiving that product as gypsum, the magnesium would be an impurity, wouldn't it?

A. Well, you can make all kinds of assumptions about what your primary product is, or about what your by-product is. We are dealing here with a particular situation. The plant was primarily designed to produce magnesium oxide.

Q. And that is one of the assumptions in which you have indulged?

A. It says so in the contract. I am not assuming anything there.

(Testimony of C. Bruce Flick.)

Q. I am not arguing with you, Mr. Flick. That is one of the assumptions in which you have indulged in coming to the conclusion that gypsum is a by-product, is it?

A. Well, I do not call it indulging in an assumption, because it is stated in the contract as a fact.

Q. Let us say it is a circumstance.

A. And in Dr. Seaton's magazine article he uses the term, himself: "This by-product gypsum would be a valueless waste if it were not for ability to sell it at a profit."

Q. What he said in fact is that the by-product gypsum would be a valueless waste unless it were for the favorable location of the plant in California, didn't he? [580]

A. Yes, but he describes it as by-product gypsum.

Q. In determining that gypsum is a by-product, you have considered and been influenced by the circumstance that the plant was built primarily to produce magnesium oxide, is that true?

A. Why, yes. The magnesium oxide is the primary product, worth \$46 a ton.

Q. How does the quantity of gypsum produced compare with the quantity of magnesium, do you know?

A. I have had no figures furnished on the relative tonnages. I might say in passing, as far as quantity is concerned, that that in itself does not necessarily govern as to by-products. I think in

(Testimony of C. Bruce Flick.)

my earlier testimony I used the example of the oyster company, which might have by-product shells that had a great deal more weight, perhaps, than the oysters, themselves.

Q. Let me ask you again, Mr. Flick, whether or not, if this calcium sulphate, which is gypsum, contained any substantial quantity of magnesia would it meet the specifications of this contract?

Mr. Bennett: That is getting into a realm here that I think you had already exhausted.

Mr. Rosenberg: He has read the contract.

Mr. Bennett: He can answer it. Go ahead.

The Witness: The contract speaks for itself. It says the gypsum shall be 97.51 per cent gypsum value, and if it drops below 95.51 per cent, then there is a penalty charge-back. [581]

Q. (By Mr. Rosenberg): And the specification states there shall not be more than 2.7 per cent magnesium, is that right?

A. I do not recall that detail, but the controlling thing we have been interested in is the percentage of gypsum value.

Q. With reference to this OPA ceiling, you did not mean to imply, did you, Mr. Flick, that because the maximum ceiling price was \$2.98, that Pacific could not pay Westvaco less than that price if it was entitled to a lower price under the contract?

A. I think I—let me say it again: The initial price was \$2.80. Westvaco's figures showed that the direct charges, which we were quite willing to recognize, had gone up 9 cents in 1941 and had gone

(Testimony of C. Bruce Flick.)

up 29 cents in 1943—that is 38 cents—and if you add 38 cents to \$2.98 you still come out with \$3.26. At any rate, even on the charges which we were quite willing to recognize, we would have paid more than the \$2.98, but the OPA would not let us. It froze the price at \$2.98. We were not interested in going back and trying to reopen something on that basis. And besides, at that time, as in fact ever since, our whole endeavor has been to find a practical way to get along under this contract and perform the contract, and we were offering at that time to arbitrate our differences. There just wasn't any point in trying to go back and reopen the price at \$2.98, with which we acquiesced, without any reference to the accounting questions, which we stated then and have ever since. [582]

Q. Referring your attention to Exhibit 19, which is a statement from Westvaco to Pacific for chargebacks from 12/31/40 to 9/8/44, it says, "Pacific Portland interpretation \$2,599.09; Westvaco interpretation \$2,084.18, difference \$514.91." Now, don't you understand from that statement, and weren't you told what was meant by Westvaco's interpretation, and Pacific's interpretation included the fact that we contended that you were not entitled to any moisture credit deductions if the gypsum content was 95.51 per cent or more, and that you in fact had taken credit deductions where the gypsum content equaled that amount but was less than 95.51 per cent, didn't you understand that?

A. No, I did not, specifically. I asked Mr. Wallace, since this statement said Westvaco interpre-

(Testimony of C. Bruce Flick.)

tation was different from Pacific—I said, “Send me the detail and show me where the difference in interpretation lies, and if we are wrong we will be only too happy to correct it.”

Q. And didn't Mr. Wallace have a meeting with you where he showed you that you had taken deductions that you now admit you were not entitled to take?

A. He never furnished me that detail and showed me where the interpretations differed.

Q. Did he ever make this general statement to you, Mr. Flick: “You people have been taking credit deductions where the gypsum content is 95.51 or more and under the contract you are [583] not entitled to such deductions unless it falls below that percentage.” Did he ever tell you that?

A. I do not recall his specifying that. As I say, I asked him to give me detail and show me where we were wrong in any case, and we would be glad to check it, and if we found he was right to send him a correction.

Q. Referring to Exhibit 20, which is the statement for \$8457.62, that covered all of the credit deductions that Pacific had taken from October 19, 1944, to August, 1946, didn't it? That was the total amount of credit deductions taken during that period, wasn't it?

A. Well, I could not be sure of that, Mr. Rosenberg, without rechecking it.

Q. You notice that the letter with which that statement was transmitted stated that, “We assert

(Testimony of C. Bruce Flick.)

that these deductions which you have made from our invoices are not authorized with respect to shipments of gypsum made after September 8, 1944, by the express terms of the agreements dated September 8, 1944, and July 25, 1945.' Now, those agreements that are referred to there were letters that transpired between Pacific and Westvaco, were they?

A. Well, one of them I think is one that you have already referred to, and that was an agreement that the price should remain at \$2.98, and I did not accept or agree with those assertions. [584]

Q. And at that time Mr. Wallace told you, didn't he, that he felt that the spirit of that agreement was that during the time that the price control continued you would not take any moisture credit deductions, and you insisted that there was no misunderstanding or agreement?

A. I told him that I thought to waive deductions of that kind under the contract would be contrary to my understanding of the OPA regulations, which prohibited raising of price, and that if you did not make deductions you would be doing the same thing as raising your price.

Q. I merely wanted that explained.

A. Whatever he said, as you have quoted him, was not in accordance with my view of the matter, and I believe that \$8000 claim has subsequently been dropped out of the picture.

Q. That is exactly what I wanted the court to understand.

A. Yes.

(Testimony of C. Bruce Flick.)

Q. You mean by dropped out of the picture, what? You have withdrawn that claim?

A. That is right.

Q. In other words, at that time Mr. Wallace contended that the spirit of the letter agreement was you would pay the \$2.98 price without any credit deductions and you denied in good faith—I am not questioning your good faith, but that was your understanding or intention, and so that is the way the matter was left? [585]

A. That is correct. It was not my understanding or intention, so far as the spirit of it was concerned, and I also told him that in my understanding of the OPA price regulations it would have been actually contrary to OPA regulations for us to discontinue making those deductions.

Q. And then subsequently, and I think it was after this suit was filed, Westvaco wrote a letter to you in which they sent a statement for the sum of approximately \$1600, which they claimed for deductions erroneously taken according to their analyses and their interpretation of the contract, and it was explained that that was in lieu of this larger sum that is evidenced by Exhibit 20, is that right?

A. I believe that is correct. That is my understanding.

Mr. Rosenberg: No further questions. [586]

Mr. Rosenberg: May I just look at my notes one second, please? I have no further questions.

Mr. Bennett: Step down, Mr. Flick.

WALTER G. DRAEWELL

called by the plaintiff, sworn.

The Clerk: Will you state your name?

A. Walter G. Draewell.

Direct Examination

By Mr. Bennett:

Q. Mr. Draewell, will you state your business and occupation?

A. I am a certified public accountant connected with Lybrand, Ross Bros. & Montgomery.

Q. That is a national firm of public accountants?

A. That is correct. I am in the San Francisco office of that firm, which is one of some 25 offices in the largest cities.

The Court: What is the name of the firm?

A. Lybrand, Ross Bros. & Montgomery.

Q. (By Mr. Bennett): You are a certified public accountant yourself?

A. I am a certified public accountant.

Q. How long have you been such?

A. I obtained my original certificate in the State of Michigan in 1926 and in California in 1930, I believe it was.

Q. How long have you been connected with Lybrand, Ross Bros. & Montgomery? [587]

A. Since I left the University of Michigan in about 1923.

Q. During that time and since that date you have been engaged in the practice of public accounting?

(Testimony of Walter G. Draewell.)

A. Continuously with the firm of Lybrand, Ross Bros. & Montgomery.

Q. To shorten this matter, Mr. Draewell, I will ask you whether in determining the cost of production or the cost of the manufacture of a byproduct what items of cost may be considered, according to good accounting practice?

A. Costs properly assignable to a byproduct are those which arise solely in connection with the byproduct operation and are ascertainable as such.

Q. Now, if the problem is the matter of comparing costs between given periods such as calendar years or any twelve month period for the purpose of determining, say, any increase or decrease in the cost of production or manufacture of a byproduct, state whether or not the same accounting methods should be employed in both periods.

A. The accounting methods when a comparison is being drawn between two periods should always be the same.

Mr. Bennett: Take the witness.

Cross-Examination

By Mr. Rosenberg:

Q. How do you define a byproduct as you used it in the testimony that you have given, Mr. Draewell? [588]

Mr. Bennett: So I may be consistent, I object to any questions as to what is or is not a byproduct because it is not proper cross-examination. The contract defines the term, the product in question as being a byproduct.

(Testimony of Walter G. Draewell.)

The Court: Overruled.

Mr. Bennett: And may that objection, to save time, run to like questions carried on?

The Court: Yes; that will be to the line of this testimony.

The Witness: A byproduct is a product recovered in the course of the production of a major or a primary product which might be in the form of a waste or impurity; it might be a material which to get the finished product will be withdrawn in the process or it might be something that is normally discharged in the course of operations in the processing of the material.

Q. Is it typical of byproduct as you can conceive it, that it is a valueless waste at the time that it comes off the production line, so to speak?

A. I think perhaps that is the most common concept of a byproduct, although I don't think it is necessarily so.

Q. Of course, you are familiar with the particular product that is involved in this litigation, are you?

A. Not directly.

Q. You have never been over to the plant? [589]

A. I have not.

Q. Over at Westvaco?

A. I have not.

Q. You are not attempting to express any opinion as to whether or not this particular product, gypsum, is a true byproduct or a joint product or co-product?

A. I am not.

Q. In other words, your testimony is completely objective and abstract, is it?

(Testimony of Walter G. Draewell.)

A. It is so intended to be.

Q. You state that in your expert opinion the only charges that should be included in determining cost of production of a byproduct are those direct charges, and if I misquote you, correct me, which are ascertainable and can be directly attributed to the production of the byproduct; is that your statement?

A. Essentially so.

Q. Is that uniformly accepted among accountants or is that your personal opinion after considering the matter generally, Mr. Draewell?

A. It is my opinion and I believe it is a more common practice and the common thought as among accountants generally.

Q. Of course, it is a common practice in accounting not to determine cost of production of a byproduct at all, is it not?

A. That depends upon the degree of importance of the byproduct. [590] The minor, trifling types of byproducts and the revenues therefrom are normally credited directly to the cost of the main product.

Q. Then, according to the exigencies and the circumstances of a particular case, you may, for business reasons, decide that it is necessary to determine the cost and keep cost records on both the product and the byproduct; is that not right?

A. You may or may not, as you see fit.

Q. Now, under similar circumstances, don't you agree that it is proper and customary to employ the same accounting methods and principles in ac-

(Testimony of Walter G. Draewell.)

counting for production of a byproduct as you do in the case of a joint product?

A. I believe perhaps when you are speaking of a byproduct, in that sense, perhaps you are speaking of a joint product rather than a byproduct.

Q. Let me put it this way: Aren't there accounting authorities who do hold to the thought that for accounting purposes any so-called byproduct that requires processing and refining to make it a marketable product, the same accounting methods and principles may properly be applied as in the case of a joint product or co-product.

Mr. Bennett: Now, we are asking him as to whether there are some accounting authorities.

The Court: Yes.

Mr. Bennett: I cite to Your Honor the case of *Davis v. [591] United States* by the Supreme Court of the United States, 165 U. S. page 373, and the particular portion of the opinion that I direct your Honor to is on page 377, a short statement by the Court.

The Court: You may cite it.

Mr. Bennett (reading): "After a witness has once qualified himself as an expert and given his own professional opinion in reference to that which he has seen or heard, or upon hypothetical questions, then it is ordinarily opening the door to too wide an inquiry to interrogate him as to what other scientific men have said upon such matters, or in respect to the general teachings of science thereon, or to permit books of science to be offered in evidence."

(Testimony of Walter G. Draewell.)

The Court: What is the factual situation there? What were they dealing with there?

Mr. Bennett: In that case a doctor was the witness, reading the remarks of the Court——

The Court: I want the factual situation.

Mr. Bennett: Yes, the facts are stated here by the Court in the opinion:

“In the course of his testimony, Dr. Amis stated that defendant ‘would sit down on his spittoon and gaze down on the floor as if looking at some object when none was there, manifesting no interest in anything that was going on; that although violently ill, he was indifferent and unconcerned during his [592] illness, was never worried about his condition, never saw any change in his expression, but he would sit and gaze in a dreamy, melancholy way, with his mouth open and underjaw hanging down, having a vacant, meaningless stare, his face expressionless—just a blank.’ In reference to this matter, he was subsequently asked this question: ‘What does medical science say as to that meaningless, vacant stare and the lower jaw hanging down in a listless way? What does medical science teach as to that?’ Which was objected to and the objection sustained and exception taken.”

The Court: My comment is that we are concerned here with relation to the interpretation of a contract where we are to develop by evidence from experts such as we have here——

Mr. Bennett: I won't argue it further, Your Honor.

(Testimony of Walter G. Draewell.)

The Court: Proceed.

Mr. Bennett: If Your Honor has made up his mind——

The Court: It is not a matter of making up my mind. I am frankly stating what I think.

Mr. Bennett: As I said, Your Honor, before, it is improper to attempt to go before the Court, as counsel sought to do with the previous witness, bring some book or something somebody said, some unsworn testimony, to bring that before Your Honor and the Courts have held in such cases in state and federal decisions numerous, indeed, that is not a proper subject of cross-examination, that the witness cannot be cross-examined [593] as to what somebody else might think. I make the further objection that by using such books or texts or any such things would be getting before the Court unsworn testimony where the other side has no opportunity to cross-examine.

The Court: It goes to the very vitals of an expert witness, what his knowledge is, the limitation of his knowledge, what he bases his opinion on. That is my thought.

Mr. Bennett: Well, I don't want to argue it any longer unless Your Honor wants argument.

The Court: No. I am giving you my state of mind. If I am in error, you will have an opportunity to correct me; that's all, that is the only reason.

Mr. Bennett: I thought I had done that. The witness can be asked as to the basis, he can be

(Testimony of Walter G. Draewell.)

asked by counsel if he wishes, what books he has read, what authorities or upon what bases he bases his opinion, but after he is qualified, and I submit that this witness has been qualified by both training and his experience and his certificate of admission to practice with certified public accountants, it is improper to get before the Court what some other person has said under circumstances where we cannot cross-examine, cannot identify the person.

The Court: As far as what somebody else said has no place in this case; that is obvious.

Mr. Bennett: Yes, Your Honor.

The Court: Proceed, counsel. [594]

Mr. Rosenberg: I think it is 4:00 o'clock. Do you wish to go on?

The Court: I am anxious to finish this case as I have other cases following. Proceed.

Mr. Rosenberg: I will put the question to you again. Is it a fact that there is a school of thought among professional accountants that holds to the proposition that where it does become necessary for one reason or another to determine the cost of producing a byproduct that it is proper to apply the same accounting principles and methods as those used in the case of any joint product or co-product?

Mr. Bennett: Same objection.

Q. (By Mr. Rosenberg): Will you answer the question?

The Court: Answer.

The Witness: I believe that there is a confusion between what is a joint product and a byproduct.

(Testimony of Walter G. Draewell.)

As to pure byproducts, I do not call to mind any accounting authority that advocates joint product accounting or have I in my experience encountered it.

Q. (By Mr. Rosenberg): You have never encountered that? A. No.

Q. Can you refer me to any treatise or text writer or paper that you have read which says that as a matter of accounting practice it is improper in determining the cost of production by a byproduct to include any indirect charges or overhead [595] expenses?

A. I cannot refer you to any specific one, no.

Q. Let me ask you, Mr. Draewell. Have you ever read—you are familiar with the National Association of Cost Accounting publication?

A. I am.

Q. I believe your firm is one of the charter members of that association, is it?

A. One of our partners.

Q. Do you read the official publication of that Association?

A. Not consistently. I am a member and I receive them.

Q. Have you ever read—you state you don't recall ever reading any text or treatise or paper that deals exclusively with the subject of byproduct accounting?

A. No, that was not your question.

Q. Have you ever read the official publication, Volume 1, No. 7, dated August, 1920, of the Na-

(Testimony of Walter G. Draewell.)

tional Association of Cost Accountants which is entitled, "Accounting for Byproducts"?

A. I have not.

Q. You have not read that. Assume, Mr. Draewell, that you have a chemical plant where the basic raw material is sea water from which a salt company extracts salt and that in this chemical plant you have three departments; in the first department you recover the bromine from the sea water and then after the bromine has been recovered from the sea water, this sea [596] water or bittern passes to another plant where gypsum is precipitated from it and is thereafter processed and refined, and then the bittern passes on to a third department or plant in the magnesium products which are recovered from this mother element, so to speak.

Now, in your opinion, on the basis of that hypothesis, can you state whether or not for accounting purposes it would be proper to treat those products as co-products?

Mr. Bennett: Just a minute. I submit the question is improper. It does not state a hypothesis that is applicable to this case. It could apply perhaps to an entirely different situation.

Mr. Rosenberg: I cannot tell from your objection wherein you differ with the hypothesis.

Mr. Bennett: There is no hypothesis that is applicable to such a situation in this case.

Mr. Rosenberg: I am perfectly willing to rest the hypothesis that I have stated.

(Testimony of Walter G. Draewell.)

The Court: In the interest of time, I will allow it. Objection overruled. Note an exception. Proceed.

The Witness: I am not familiar with the process of the raw material. If the bittern, I believe you call it, is the primary product which passes through each of these processes and it is then—in other words, if there is a diversion of bittern into various products, they would be co-products. If, [597] on the other hand, the basic material proceeds on to a final product which may be the end or the primary product, anything that passes off, if there is a specific material abstracted or withdrawn at a point before the final operation, both of them would be byproducts until you would have your primary product, the magnesium.

Q. It is your theory, is it, that if you have a chemical plant and you have a common raw material from which you recover a number of chemical elements, every process, every element removed is a byproduct up to the point where the raw material reaches the last point of processing?

A. Not entirely. You have first a primary purpose or primary product for which the plant is operating. I don't recall if there is a diversion of the product from the raw material or is it a removal of the raw material from that? If the primary raw material passes on into separate branches, it is really in effect a co-product.

Q. Do I understand your answer you are influenced in your determination of whether or not

(Testimony of Walter G. Draewell.)

the main and primary purpose of the plant is to produce one product?

A. Whatever the primary purpose is. You may have a main product, you may have joint products, all of which perhaps share jointly in the purpose for which the plant is being operated.

Q. The fact in the chemical industry where you take a common [598] raw material and at different stages of the operation recover different commercial elements from it, wouldn't cause you necessarily to conclude that each element removed up to the last point is a byproduct, would it?

A. If it was a diversion of the original raw material or in its form at that particular stage of the process, I would say it probably becomes a co-product; if on the other hand, it is—when a removal of an impurity or something that is not an impurity, something that is not necessary on the end product that may very well become and in some plants it would be regarded as being a byproduct.

Q. And when we are talking about the co-products or byproducts, we are talking in the accounting vernacular; in other words, you are using the term as it is recognized by accountants for the purpose of determining the accounting method to be employed in connection with it?

A. I have no knowledge of the scientific meaning of the byproduct.

Q. Let me ask you, have you had any personal experience in cost accounting for a chemical plant?

A. Such as I have had is so long distant that

(Testimony of Walter G. Draewell.)

the experience of itself is not worth the mention at this stage.

Q. So you know nothing of actual experience in a chemical plant upon which you base these particular opinions?

A. No. I had this experience, as far as magnesium oxide is [599] concerned, of the end product in the case being metallic magnesium which was produced differently, from the raw dolomite and following it through to magnesium oxide produced by process and then into the chemical plant by which process magnesium, metallic magnesium, was produced.

Mr. Rosenberg: I think that is all.

Mr. Bennett: That is all, Mr. Draewell.

The Court: We will recess now until tomorrow morning.

(Whereupon the trial was continued until tomorrow morning, Thursday, December 18, 1947, at 10:00 o'clock a.m.) [600]

Thursday, December 18, 1947, 10:00 o'clock a.m.

O. KENNETH PRYOR

was called as a witness on behalf of the plaintiff and being first duly sworn, testified as follows:

Direct Examination

Q. (Mr. Bennett): Mr. Pryor, will you please state your business and occupation?

A. I am a certified public accountant in the practice of public accounting. I am a partner of the firm of Price, Waterhouse & Company.

(Testimony of O. Kenneth Pryor.)

Q. Price, Waterhouse & Company is a firm of certified public accountants with offices throughout the United States?

A. Yes, we have many offices in the United States, an office in San Francisco, and in addition we have a great many offices throughout the world.

Q. You are a resident partner of that firm?

A. I am.

Q. How long have you been a certified public accountant?

A. I took the examination in New York State in 1929 and was granted my certificate in June of 1930.

Q. Since that time you have been engaged continuously in the practice of accounting?

A. I have, sir.

Q. Mr. Pryor, as an accountant, if you are to determine the [601] actual cost of production or actual cost of manufacture of a by-product, what elements or items of cost are to be included in any such computation?

A. Let me say one thing to start with: To my mind, as an accountant there is no difference between cost of production and cost of manufacture. They are synonymous terms, I believe, in accounting.

Q. You tell us what items or elements of cost are to be included in determining the cost of production or the cost of manufacture of a by-product.

A. I think that you might say that the elements of cost which are to be included in the cost of pro-

(Testimony of O. Kenneth Pryor.)

duction of a by-product would be those necessary expenses which are directly and solely attributable to that by-product and which you can ascertain in amount.

Q. In the case of a situation where not only the manufacturer or producer of the by-product but the purchaser of that product is concerned with the determination of the cost of production or the cost of manufacture of the by-product, and where there is a problem of determining and actual advance in the cost of manufacture, if any should occur in a twelve month period as compared to a previous twelve month period, what would be the elements or items of cost to be determined or upon which any such actual advance in cost of manufacture or cost of production would be based? [602]

A. You have set up a situation where it is important, of course, to determine cost based upon two comparative periods. In that situation there are certain things which have become very important, namely, the consistency of the application of the proper principles as to what elements should be included; I think, as I stated as to a general proposition, only those elements which are solely attributable to that by-product and which you can ascertain with exactitude. In other words, you do not have the leeway perhaps that you might have if you had some other purpose in mind in determining those costs.

Financial statements, of course, may serve many purposes: reports to stockholders of the steward-

(Testimony of O. Kenneth Pryor.)

ship of the management, preparation of income tax returns, fiscal policies, determinations as to whether dividends might be legal, costs under a contract such as this—any number of purposes. Obviously they can not serve all purposes equally well, so that it is almost impossible to divorce the question of purpose which you have in mind, because where you have a specific purpose you are obligated to be very much more accurate in a case such as you have described than if you were just keeping books for some other purpose.

Q. State whether or not indirect charges of the manufacturer which would have been incurred if the by-product had not been produced, but in lesser and unascertainable amounts would be included in the cost of manufacture or cost of production in the [603] situation that I last mentioned to you of the comparison of two yearly operations.

A. I do not think that an expense of that type belongs in the cost of production of a by-product. It can not be ascertained and it might go on of whether or not there was a by-product produced. Therefore I do not think that it should be charged to a by-product.

Q. I hand you herewith, Mr. Pryor, Plaintiff's Exhibit 15, which is an exhibit to the answer by the defendant to plaintiff's interrogatories in this case, and direct your attention to certain words and figures that appear in two columns and two purported comparative periods, the first being July 1, 1944 to June 30, 1945 and the other period from July 1, 1945 to June 30, 1946.

(Testimony of O. Kenneth Pryor.)

I might say to Your Honor that this is Exhibit 15. The witness Webster dealt with Exhibit E. Exhibit E, which Webster dealt with, had to do with the so-called second price increase. This particular exhibit, Exhibit F, has to do with the periods involved in the claimed third or last claimed price increase.

Q. Now, Mr. Pryor, taking the items appearing in subparagraph B of the exhibit which you have in your hand, please state whether or not in your opinion the items appearing in the left-hand column should or should not be included among the costs of production, the costs of manufacture of the by-product, keeping in mind for your information the notations and statements which [604] appear on the right-hand column opposite the particular item of cost set forth in the left-hand column.

A. The first item on the exhibit is described "Supervision," and the basis as shown is "Allocated." I do not believe that an arbitrary allocation of a thing like that results in a direct charge. Supervision, I presume, would go on whether or not there was produced by-product gypsum, and I do not believe that that type of thing belongs in here.

I might note that on the schedule there is no change in the item between the two periods, although I do notice that there is a footnote which indicates that in the first of the two periods 18 per cent apparently of supervision was allocated to supervision, whereas in the second period 26 per cent was allocated to supervision.

(Testimony of O. Kenneth Pryor.)

Mr. Kaapeke: To gypsum, you mean.

A. To gypsum. Excuse me.

Q. (The Court): Where is that?

A. May I point it out to Your Honor? There is no change in supervision as indicated for the periods, but in the first period they have allocated 18 per cent to gypsum and in the second period they have allocated 16 per cent to gypsum.

Q. (Mr. Bennett): What effect, if any, would that difference of percentage of allocation have in your determination?

A. None whatever as to the inclusion of the item. I do not believe it belongs in there at all. But, of course, if there is [605] a change in accounting basis or a change in method of allocation, it becomes rather arbitrary, it seems to me, which is a further reason why some other type of item might not be includable, in my opinion.

Q. Assuming that this item of supervision which you just mentioned was a charge which would have been incurred had no gypsum been produced but in lesser and unascertainable amount, state whether or not that would also be a separate and distinct reason for either including or not including the item of supervision.

Mr. Rosenberg: To which I object on the ground it assumes a fact not in evidence. Where is the basis for that?

Mr. Bennett: The basis is simply this, counsel: In your answer to the interrogatories, under 10G you state, "See Exhibit F," attached hereto. And

(Testimony of O. Kenneth Pryor.)

then you say, "None of the direct charges shown on Exhibit F would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit F would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts."

Now, I assume from the very nature of the exhibit which you have referred to in your answer, which is in evidence, that this item of supervision is one of the indirect charges that you referred to, but wholly aside from that assumption, which I think we are entitled to draw, I am entitled to ask this witness as a basis for this question an assumption. In other [606] words, if the interrogatories themselves do not make it clear that the item of supervision is classed by you in relation to the statement which I have just read as not an indirect item as you mentioned it, I am at least, for the purpose of this examination, entitled to ask a question on the assumption that it is, and then the witness' answer will or will not be relevant in this particular, depending upon further facts as they are developed. We can not try our whole case, as Your Honor knows, in one question. Perhaps all this question can be resolved, counsel, by you answering my inquiry now of whether or not the item of supervision, paragraph B of Exhibit F, is one of the indirect charges which you mention in your answer 10G to the plaintiff's interrogatories being an indirect charge.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: I frankly do not know, Mr. Bennett.

Q. (Mr. Bennett): I will ask you, Mr. Pryor, according to your understanding, where an item is one that is allocated, would you consider that a direct or an indirect charge?

A. I would consider it an indirect charge.

Mr. Bennett: Very well. I would like the witness to answer my question.

The Court: Read the question.

(The Reporter read as follows:)

“Q. Assuming that this item of supervision which you just mentioned was a charge which would have been incurred had no gypsum been produced but in lesser and unascertainable amount, [607] state whether or not that would also be a separate and distinct reason for either including or not including the item of supervision.”

A. I think that would be another reason for excluding it from the cost of manufacture of the by-product gypsum.

Q. (Mr. Bennett): Take the next item, “Labor Operations.”

A. Labor operations has opposite the notation “Actual time card distribution,” which would lead me to believe that they had computed that based upon time cards, in which case I think it is direct and I believe it belongs in the cost of production of the by-product, and I assume in saying that that is the labor which is involved in the actual finishing of the by-product from the point of separation.

(Testimony of O. Kenneth Pryor.)

Q. How much of an increase in the comparative period, that is, in the year July 1, 1945 to June 30, 1946, is there over and above the preceding twelve month period, if any?

The Court: Is there any question about that labor charge, the allocation?

Mr. Bennett: No, Your Honor.

The Court: Why spend any time on that?

Mr. Bennett: I just wanted to have a computation here of the items that are agreed to, or which this witness feels should be included.

The Court: You can not get anything more definite than that, than the time card showing of the actual labor. I will [608] stand corrected if there is any question about that.

Q. (Mr. Bennett): There is a three cent increase?

A. There is a three cent increase in that item.

Q. The next item, "Labor Repairs."

A. The same notation is opposite it, and assuming that that was the labor for repairing machinery used in the finishing of the by-product from the point of separation, then I think that belongs in there. There is an increase in that item of four cents per ton.

Q. The next item, "Material Operations,"—and this is one item in which there is a detail which I think we should develop—what would you say as to that item?

A. It says, "Material Operations," which I presume means materials used in the direct manufac-

(Testimony of O. Kenneth Pryor.)

turing of the by-product gypsum. It says "On direct purchase and storeroom requisitions," and I think it belongs in the cost of production of the by-product. There is an increase of three cents in that item.

Q. Assuming that one cent of that increase resulted by reason of a change in accounting methods, then what would you say, Mr. Pryor?

Mr. Rosenberg: To which I object on the ground it includes a fact not in evidence.

Q. (Mr. Bennett): Assuming that in the second period one cent of that three cents was for an air compressor, which charge for the first period in comparison was carried under the [609] title of "General Plant Expense," what would you say in connection with the propriety of including that one cent charge for the air compressor in the second period, whereas in the first period it was charged to general plant expense?

Mr. Rosenberg: Same objection. You are apparently reading from something, but I am sure there has been no evidence up to this point of anything of that nature.

Mr. Bennett: Counsel, we will develop that. As I said before, I can't prove the whole case in one question.

Mr. Rosenberg: That is right, but it is up to you to have your foundation laid before you put a hypothetical question to the witness.

Mr. Bennett: All right, if you wish to take time to do that now.

(Testimony of O. Kenneth Pryor.)

Counsel, I will ask you if it is not a fact, to save time, that in the first period involved in this comparison presented by Defendant's Exhibit F to their answers to plaintiff's interrogatories, one cent of that claimed 3 cent increase during the second period, July 1, 1945, to June 30, 1946, involved a charge for air compressor, which in the previous period, the 1944-1945 period, had been charged as against general plant expense.

Mr. Rosenberg: I do not know. If you will tell me what source you are getting that information from, Mr. Bennett——

Mr. Kaapeke: Claude, I will state the source of it: [610] In my office Mr. Watt and you had a conversation. I was sitting at the same table. You turned to Watt, and the discussion was over this air compressor. You asked him if that change was made, and he said, "Yes."

You said, "Is that one cent?"

And he said, "Yes."

And if you do not care to stipulate to that, all right.

Mr. Rosenberg: If that is a fact,—frankly, I do not recall that. I do not doubt that it occurred if you say it occurred. However, I would submit this. Your Honor: If it was in another account in the prior period and you put it in a different account in the second period, then if you are going to take it out of the account, you should put it back in the account it was in in the previous period, according to their theory, so it would not necessarily record any change.

(Testimony of O. Kenneth Pryor.)

Mr. Kaapeke: That is what was done, saving for the moment the question of whether general plant expense should go in or not.

Mr. Rosenberg: I will withdraw my objection subject to your offer to lay the foundation later.

Mr. Bennett: We could stop this and call Mr. Watt.

Mr. Rosenberg: I have withdrawn my objection for the time being.

The Court: Let the witness answer the question.

(The question was read as follows:) [611]

“Q. Assuming that one cent of that increase resulted by reason of a change in accounting methods, then what would you say, Mr. Pryor?”

A. I would say that the accounting methods should be the same in both periods, if you are going to compare the two periods, and I do not believe that a change in accounting method should be made where it results in increasing a price under a contract, or where you are comparing two periods, even if there is a contract.

Q. (Mr. Bennett): As to that item and assuming the correctness of your theory and reason, there would be, instead of three cents, allocated to increased cost two cents, is that correct?

A. That is correct.

Q. Take the next item, please, “Material Repairs.”

A. Material Repairs. That is apparently from the description on the exhibit based on storeroom requisitions and direct purchases, and so long as they applied to repairing things in the gypsum

(Testimony of O. Kenneth Pryor.)

operations directly, I would have no objection whatever to including them in cost of production. There was an increase in that item of 9 cents.

Q. The next item.

A. The next item is bittern. From what I have heard here before, I take it that is raw material which starts at the beginning of this plant, and I do not believe that it therefore has [612] a place in the cost of manufacture of a by-product.

Mr. Bennett: May I interrupt here? Your Honor has, for the purpose of accelerating this trial, which is a proper thing, stated that where matters do not involve an actual claim of increase for any period, we can skip that. The only reason I am mentioning this point now is that while this period there does not appear to be an increase in the charge of bittern——

The Court: There is a deduction.

Mr. Bennett:—there is a question in the final decision of this case as to whether or not bittern is a proper basis of cost, which will have to be determined by the Court, and the reason I asked that specific question of the witness was so that Your Honor will have such benefit as his testimony gives with reference to these disputed items.

Mr. Rosenberg: Then, Mr. Bennett, wouldn't it be proper—I presume the purpose of writing these figures on the board is to show the results of this witness' opinions. So to be consistent there should be another two cents on there, shouldn't there, because we gave you the benefit of the reduction in bittern cost, and he said that that is im-

(Testimony of O. Kenneth Pryor.)

proper. Bittern should not be included at all. Now, you do not want to take the benefit of that two cents according to this witness' testimony do you?

Mr. Bennett: I suggest we carry this 2 cents but you made your comment, counsel. The problem is not as simple as you are stating it. We will put on the board this item of bittern, 2 cents, we will put it down so there won't be any question of it.

Q. The next item of water, My Pryor.

A. There is no charge in that item. It is marked out on the side, "At cost measured." I presume it is used directly in that gypsum process and the finishing of the raw material, and I would have no objection to that item of expense being included.

Q. Next item, power.

A. Same thing can be said for power.

Q. Gas.

A. In the case of gas, for the same reason I would include it; there is an indication of one set.

Q. Fuel oil.

A. I cannot tell from looking at this statement whether there has been a change in accounting bases or not. There is a zero in the first column, and 1 cent in the second column. If it is a product which was introduced, that is a fuel which was introduced in substitution of some other fuel, and it was necessary to have them use it directly in the process, then I would have no objection to its inclusion, and it would show an increase of one cent.

Q. Next item, sulphuric acid. In considering that item I wish [615] you to consider and assume

(Testimony of O. Kenneth Pryor.)

that the sulphuric acid is added in the manufacturing process prior to the point in time of separation of the by-product in this case.

A. I should like to add to that assumption that if that was placed in there necessarily and solely for the production of the by-product gypsum: In that case I have two things to say about the item. First thing, I do not believe it belongs in there under those circumstances at all. In the second place, it would appear that they might have some change, there might have been some change in accounting method and the apparent increase that are simply the result of changes in accounting methods or bookkeeping increases, so to speak, I believe have no place in a comparison where you are trying to get down to unit cost comparing one period with another.

Q. Assuming that up until the period July 1, 1945, or from July 1, 1945, to June 30, 1946, the manufacturer had never charged or sought to charge any sulphuric acid to the cost of producing the by-product in question, but had charged it to some other product, how would that affect your answer?

A. Well, I should say that that would be a change in accounting basis and therefore would eliminate this item.

Q. Take the next one, the item "Overhead," and assume that the item Overhead involves costs which would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts,

(Testimony of O. Kenneth Pryor.)

what would your answer be as to whether or not the [614] item of overhead appearing on Exhibit F should or should not be included in the cost of production or manufacture of the by-product, and whether or not any actual increases or advances in such cost should be considered for such comparative period.

The Court: On a labor basis? That item is on a labor basis?

Mr. Bennett: Yes, your Honor, if you wish that; I will follow that up.

The Court: That is the label on the item.

Mr. Bennett: No. What that means, your Honor, as I understand it, is that these——

The Court: Allocated on a labor basis.

Mr. Bennett: Allocated on a labor basis. In other words, the defendant claims that it is entitled to allocate this plant overhead for certain items for the Western Division and overhead for certain items in the New York office on a basis of applying the relation of the direct labor charge that they have for the gypsum industry as that bears to direct labor charge in some other operations, the details of which I don't know.

Mr. Rosenberg: Let's be fair, Mr. Bennett. If you are making a statement as to what the defendant's contentions are let's state it correctly.

Mr. Bennett: Well, you say it.

Mr. Rosenberg: Our contention is we are entitled to allocate [617] general overhead at the

(Testimony of O. Kenneth Pryor.)

Newark plant on the basis that the direct labor employed in processing the gypsum from the time it is separated from the bittern bears to the entire labor in the Newark plant.

The Court: That was my understanding.

Mr. Bennett: That is all right if that is your understanding. I understood your question to me was that this item of overhead included labor charge.

The Court: I said on a labor basis.

Mr. Bennett: Yes. Now, Mr. Rosenberg, is it not a fact that among the items of overhead charges that you include in this total as appearing in this Exhibit F to your answers to plaintiff's interrogatories, not only overhead for the operations of the plant at Newark are involved, but also overhead of certain items, certain items of overhead at your western division and your New York office?

Mr. Rosenberg: Oh, no. I will say the answer is "No," Mr. Bennett. I would say this, that considered as part of the overhead expense of the Newark plant is a portion of New York general and administrative expense that is allocated by the New York office to the various plants throughout the country by the Westvaco Chlorine Products Company, including Newark, but I did not want you to create the impression that the New York expense is allocated to the Newark plant according to the relation that the direct labor of both products should bear [617] toward each other because that is not true.

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: Based upon the situation as outlined by the comments of his Honor and the comments of Mr. Rosenberg, Defendant's counsel, and myself, state whether or not the item "Overhead" as it appears on Exhibit F and any claimed increases appearing on that exhibit should be included in the cost of production for the purpose of this comparative period?

A. I do not believe that any part of it belongs in the cost of producing the by-product.

Q. You would therefore disallow any increase as claimed on Exhibit F for that particular item?

A. I would.

Q. The next item involves three items grouped together, taxes, insurance, and depreciation. I refer in connection with that particular item your attention to the items, the breakdown details of each of those items as appears on the first page of Plaintiff's Exhibit 18.

The Court: Taxes, insurance and depreciation.

The Witness: Yes. Taking the items in the order that they are on the exhibit which you have just handed to me, the first item is insurance, in which there is shown——

The Court: Taxes, isn't it?

A. In your copy, I believe—the exhibit you are looking at, your Honor, it is—— [618]

The Court: Oh, I see.

The Witness: I am looking at this and the first item is insurance.

(Testimony of O. Kenneth Pryor.)

The Court: Yes.

The Witness: In which there is shown a decrease of one cent per ton. As to insurance, we, of course, have to know, I believe, in the present circumstances, what type of insurance it was.

Q. Let us assume it is insurance on fire and other risks of property, both real and personal.

A. In the case of fire insurance, and in this particular instance I think there might be good reason for leaving it out on the theory that it represents a policy matter, the company has decided to assure itself against the risk of loss of capital, and I think there might be good justification for leaving it out, but I might say, Colonel Bennett, that in many companies it is included. I know of companies where it is excluded from cost of manufacture. I know of companies where it is included. Frankly, I wouldn't quarrel with the way it has been done here.

Q. If that insurance item bore a direct relation to the particular items of property, real and personal, devoted to the processing of gypsum after its separation, then you say you would not quarrel with it, although it is a matter that could or could not be included? [619]

A. That is correct. Of course, I do not think any insurance that does not relate to the particular properties used in this drying and grinding or the by-product has any place in the cost of the product, or the by-product.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: I will move that go out; there is no basis for any such statement.

The Court: It may go out.

The Witness: I beg your pardon.

Q. (Mr. Bennett): Take the next item, please, Mr. Pryor.

A. The next item is labeled "Taxes on real and personal property." There is no change during this period.

Q. Assuming there was a change during that period, what would be your view with reference to the propriety of including such an item, and if there are any conditions for that what conditions would there be?

A. I think that goes to a basis of determining as to the item, itself. I would have no objection to including it in cost of production of a by-product if it related to the properties that are used in the finishing of that by-product. If it can be determined, for example that the assessor had valued those particular properties in the plant at X dollars, then I would have no objection to applying the applicable tax rate to those X dollars to determine how much should be included in the cost of production of gypsum.

Q. Take the next item. [620]

A. Depreciation shows a decrease in the cost per ton of 2 cents in this period. As to whether or not depreciation belongs in here as cost of manufacture of the by-product I would say that if it

(Testimony of O. Kenneth Pryor.)

applies to the particular facilities used in the finishing of that by-product it would be so, but I would like to qualify that to this extent, and that is that I believe that where you are comparing two accounting periods and reducing each result to a unit of production basis, that you would be justified in eliminating any other type of allocation of depreciation other than a unit of production method of computing the depreciation.

Q. What about the next item, Inter-departmental charges?

A. Are you still referring to the——

Q. No; I thought that covered taxes, insurance and depreciation. Haven't you?

A. Yes, I have. I see you are going now back to Exhibit F.

Q. Inter-departmental charges.

The Court: At cost.

Mr. Bennett: At cost. There is no apparent increase or decrease or decrease as to that item, but assuming that there was an increase, should that item be considered or included as cost of production?

A. Will, I notice up at the top of this exhibit, or further up on the exhibit there was "Water at cost measured." I do not know what the nature of this inter-departmental charge for water at cost is; if it represented an item of water, comparing actual cost that was used solely in the production of [621] the gypsum by-product I would have no

(Testimony of O. Kenneth Pryor.)

objection to including it, but if it represents some arbitrary allocation of overhead, more or less, I wouldn't think it would be includable.

Q. What about the last item, Shipping expense? In that connection, please keep in mind the explanation that appears on the right-hand column of Exhibit F, and also assume, Mr. Pryor, that 2 cents of that claimed cost of 28 cents per ton during the latter period involved indirect charges which would have continued if production of gypsum, or if no gypsum had been produced but in lesser and unascertainable amounts?

A. Perhaps I can save a little time here——

Mr. Rosenberg: Just a minute. I suggest, Mr. Kaapecke, you do not anticipate the witness by writing on the board.

Mr. Kaapecke: Oh, pardon me.

Mr. Bennett: Go ahead.

The Witness: I might save a little time if I explained first that shipping expense is ordinarily not considered manufacturing expense, but I understand that it is not in contest here, and it is agreed that shipping expense, because of the wording of the contract, is to be included, nevertheless. With that preliminary I would say that the actual out-of-pocket expense over in the by-product plant of shipping the gypsum would be includable for this purpose. Now, as to the indirect items that you mentioned of 2 cents, I do not believe that such indirect items should be included. There is an [622] apparent increase here on the face of the exhibit of

(Testimony of O. Kenneth Pryor.)

7 cents, so that if 2 cents was indirect, I would say there could only be an increase in this particular item of 5 cents.

The Court: Is there any hope of concluding with this witness?

Mr. Bennett: I think that is all, your Honor.

The Court: It is after 12 o'clock. We will take a recess until 2 o'clock.

(A recess was thereupon taken until two o'clock p.m.)

Thursday, December 18, 1947, 2:00 o'clock p.m.

Mr. Bennett: I have one or two questions.

O. KENNETH PRYOR

resumed the stand.

Direct Examination (Continued)

Q. Prior to the noon recess, we were discussing and you were giving your opinion with reference to the items of cost bearing on Exhibit F of the defendant's answers to the plaintiff's interrogatories, and we completed, as I understand it, all the items appearing on that page. Will you state for the record, Mr. Pryor, the total amount of actual increases or increase in the cost of production of gypsum in the 1945-1946 period, if any, over the preceding twelve month period?

Mr. Rosenberg: That is based upon the same assumptions that the witness has been indulging in throughout his testimony?

Mr. Bennett: That is correct, Your Honor, and also on the assumptions that the figures and state-

(Testimony of O. Kenneth Pryor.)

ments contained in Exhibit F of the defendant's answer to our interrogatories are correct.

A. I think that the increase in the cost of production of the by-product gypsum for that period which would be proper under the contract, would be 25 cents.

Mr. Rosenberg: Just a moment. I am going to ask that that answer be stricken. I did not understand that this witness was to construe the contract.

Mr. Bennett: I did not say anything about the contract. [623]

The Court: He could not control that answer.

Mr. Bennett: Disregarding your understanding of the contract, but based upon opinions and views that you have previously expressed and upon your consideration of each of the items of cost set forth on Exhibit F of the defendant's answers to plaintiff's interrogatories, state the total amount of the actual increase, if any, of the cost of production for the period 1945, July 1, 1945, to June 30, 1946, over the preceding twelve month period.

A. 25 cents per ton.

Q. If these items of depreciation, insurance and bittorn are proper to be considered as actual costs or as costs of production or manufacture of gypsum and allowable as such, what would be the total amount of increase in the period mentioned in the preceding question?

A. It would be 25 cents less 5 cents for those three items, or 20 cents per ton.

(Testimony of O. Kenneth Pryor.)

Q. Mr. Pryor, you have testified that you eliminated this item as stated as overhead in Exhibit F to defendant's answers to plaintiff's interrogatories, and assuming again that the problem is the comparison between the two year-periods in question that I have just mentioned, the purpose is to determine any actual advance in the cost of manufacture of gypsum, and such determination is one in which not only the manufacturer is interested but also the purchaser—in other words, the rights or obligations [624] of both the manufacturer and the purchaser of the gypsum are to be affected by such determination—state the reason or reasons, if any that you have, why you would exclude such item denominated, "Overhead."

Mr. Rosenberg: Do I understand that the witness is testifying that it would be proper to include overhead, that it would be in accordance with good accounting practice to include overhead for a by-product if no one other than the producer were affected?

Mr. Bennett: No, I do not understand him to say that at all, counsel, but I am asking this question, as I am entitled to ask it, from an accounting point of view where the comparison——

The Court: It is rather involved, and I suggest that you break it up by asking direct questions so that I may be able to follow the testimony.

Mr. Bennett: I will do that. I thought I had already asked the direct question.

(Testimony of O. Kenneth Pryor.)

The Court: I do not know whether you are conscious of it. It may be myself. In asking these questions, they become so involved, I should think if you would break them down in some fashion so I could follow them directly, it would be helpful.

Mr. Bennett: I will have to repeat a little bit.

The Court: That is all right.

Q. (Mr. Bennett): You have already stated, Mr. Pryor, you [625] would disallow this item denominated overhead in defendant's Exhibit F to the defendant's answers to plaintiff's interrogatories. You disallowed that item, as I understand it, both from the point of view of being a proper allowance for inclusion in the cost of a by-product, and you also disallowed it, as I understand it, with reference to the specific problem of the comparison of cost to determining any increase between these two periods mentioned in Exhibit F, is that correct? A. That is true.

Mr. Rosenberg: I am not conceding that to be true by not stating anything. I do not think the witness has said that if it was proper to include overhead in the first period, it would not be proper to include it in the second period for comparative purposes. He has not said that.

Mr. Bennett: I did not intend to indicate that he said that, counsel. I think both of your comments were not germane to my questions at all.

Mr. Rosenberg. All right.

Mr. Bennett: And it tends just to confuse.

Q. For the purpose of comparison of those two year-periods and for the purpose of determining

(Testimony of O. Kenneth Pryor.)

what actual advance, if any, in the cost of manufacture for the latter year period as compared to the first year period, there is, why would you disallow the item embraced in this classification of overhead as appears on Exhibit F of the answer to the interrogatories? [626]

A. I think that in the case of a by-product it has no place there. If you inject the other thought of another party involved it may be affected by your determination. It accumulates an error that you might make if you include it, because as you look at overhead in relation to a price fixing, then you must, of course, remember that by increasing the overhead in one period, by spending more money and decreasing it in another period by spending less money, you get an increase which, if you reverse the process again and again and again, it accumulates and accumulates. Now, that just does not make to me good business sense from an accounting point of view to do that, because, after all, a business man, when he looks at a by-product he thinks of it in terms of out-of-pocket. That does not mean overhead. He looks at it this way: If I produce a by-product my direct expenses are 10 cents and I can sell it for 11, I can make a cent. But if he allocates overhead and a lot of other expenses that would go on whether he made the by-product or not and he finds it costs 12 cents or 2 cents of overhead added to that, he would say, "Well, I won't make the by-product." And that does not make business sense, because by not making it he would lose a penny.

(Testimony of O. Kenneth Pryor.)

Q. State whether or not there is a greater or lesser reason or purpose in excluding such items of overhead as we have discussed here in your testimony in the case where not only the manufacturer is concerned with his cost accounting, but the purchaser [627] of the by-product is concerned with the amount of any actual increase in such costs of manufacture?

A. Well, I would answer that question this way: In computing the cost of manufacture of a by-product, I do not believe that good accounting would permit those things being charged, even if no one else were concerned, but if somebody else was concerned, I think it becomes imperative that he eliminate them.

Q. And why do you consider that it becomes imperative to eliminate them as costs of manufacture upon which any price increase would be based?

A. I think it is for the general reason that it does not fall in the case of manufacture of by-product, according to my original definition, but to put them in in the case you just described would give the seller, it seems to me, the power to affect the price—I do not like to use the words “legitimately” or “illegitimately” because I do not believe that that is necessarily the correct way to put it, but he would have certain powers of affecting the contract that I do not believe he should have.

Q. Would the fact that the manufacturer was willing to or did allocate such indirect or overhead items on a labor basis make any difference? That is,

(Testimony of O. Kenneth Pryor.)

would it make proper the inclusion of indirect and overhead charges?

A. I do not think that the basis of allocation is of the essence here. It is whether it should go in in the first place or not. I can think of a situation, for example, on the allocation point [628] where in the production of the principal product perhaps there is relatively little labor. It is a by-product process, and where the finishing of the by-product might involve a great deal of labor, and even assuming, which I do not for a minute assume, that overhead items should be allocated in some way to a by-product, certainly a direct labor basis would not be a proper basis under these circumstances.

Q. Assuming a situation such as a manufacturer of a by-product, gypsum, where there is a primary product, magnesium oxide, produced, whereas at the beginning, say, of any period of operation, the first year or so of its production, a great deal of labor was used in the production of the magnesium oxide, the primary product, but a change was made where in the place of labor, labor saving machines were employed, but so far as the production of gypsum was concerned, of by-product, the amount of labor that was used relative to the production continued on without substantial change; what would you say as to such a situation as that?

Mr. Rosenberg: To which I object on the ground it assumes facts which are completely the figment of counsel's imagination. There is not an iota of evidence in this record to sustain any such ridiculous

(Testimony of O. Kenneth Pryor.)

assumption for this witness to indulge upon. You can go, Mr. Bennett, to the limit where all of a sudden there was no labor for gypsum and ask him what the result would be, and what materiality would that have in the determination [629] of this case?

Mr. Bennett: Your Honor, I will concede that I am assuming a situation, but I think the assumption of that situation is definitely legitimate for the purpose of laying a foundation of the witness' views. He has already stated that the mere fact that allocations are made on a labor basis would not in his opinion give validity to such allocations. Now, this question was directed by way of a possible illustration. It might be applicable or not. That is for the witness to determine so far as his testimony is concerned.

Mr. Rosenberg: Oh, no, it is not for the witness to determine whether there is any foundation.

The Court: Counsel indicates you are assuming a fact not in evidence. There is no evidence in this case that embodies anything in your question.

Mr. Bennett: No, but a situation of that kind, if Your Honor please, may be used for the purpose of illustration.

The Court: I understand.

Mr. Bennett: And I am frank to confess that there is no evidence, so far as I know, that there has been a complete change in the method of manufacture of magnesium oxide. There have been some bookkeeping changes. They now charge, for ex-

(Testimony of O. Kenneth Pryor.)

ample, sulphuric acid, against the by-product. We need not go into that phase of the matter now, but I wanted to illustrate, if possible, situations that would give graphic [630] illustrations to what the witness is talking about, that the mere fact that items which are not ordinarily considered included in the cost of manufacture, do not become valid or appropriate merely because they are allocated on a labor basis.

Q. (The Court): Do you understand the question? A. Yes, I do.

The Court: You may answer it.

A. Again I would like to repeat that I do not think that any part of it would belong in the by-product, but if we assume that that would be the basis we should go on, then I think [631] those allocations should be made on a realistic basis and one which conforms to facts, and if there had been a substantial change in relative labor, if they started off on that basis and it was proper at the beginning, then I think it would call for a change in the basis of allocation.

Q. (The Court): What do you have in mind when you say a realistic basis?

A. One that conforms to what a reasonable business man and an accounting looking at it from that point of view would adopt. Accounts, Your Honor, are utilitarian to this extent, that they must have some semblance of business reason back of them.

The Court: Very well. Proceed. Is that all from this witness?

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: Yes, Your Honor.

The Court: Proceed. Let us get along.

Cross-Examination

Q. (Mr. Rosenberg): Mr. Pryor, first, to go into something that was right at the end of your testimony, you were speaking of overhead and you said the reason you did not think that should be included in the cost of production of a by-product is because it would rest within the power of the purchaser, of the manufacturer, rather, probably to jockey his overhead expense up or down in different years that might be used for a comparative basis. Was that the essence of your testimony?

A. No, I do not think so. [632]

Q. What did you mean?

A. The essence—that was based upon an assumption which was given me. The essence of my testimony I believe has been that overhead should not be charged to the by-product.

Q. And then you were asked, “Well, now, if the cost of production of the by-product to the manufacturer is going to affect a purchaser of that by-product, is there more reason for the opinions that you have expressed?” And I believe you said yes, and then you explained why, didn’t you?

A. I merely said,—I think I started off my remark by saying, “I do not believe that it belongs in at all.”

Q. I understand that. Now, will you tell me what you told Mr. Bennett when he said, “Well,

(Testimony of O. Kenneth Pryor.)

now, if somebody else is going to be affected by that cost of production, do you think that that is all the more reason for not including that?" Do you remember that? A. I remember.

Q. And you said yes?

A. No, I didn't say "yes" in so many words. I said this—

Q. (The Court): In substance and effect, if I followed your testimony, it was that. If I am in error, you may correct me.

A. Yet me restate the thing.

Q. Yes.

A. I stated I did not think it belonged in the cost of [633] production of a by-product at all. If by some reason it should be under any theory, which I do not know what theory it could be, but if it should be, certainly that would have an effect on it, just as it would have an effect on the price of the major or primary product.

Q. (Mr. Rosenberg): And then didn't you say something about the fact that the overhead might be up in one year and down in another year, and therefore you would get what in effect would be a fictitious result? You did not use those words, but isn't that the meaning that you intended to convey?

A. I did not mean to convey it with relation to the by-product necessarily.

Q. Let me ask you this, Mr. Pryor: You will concede, won't you, that ordinarily overhead ex-

(Testimony of O. Kenneth Pryor.)

pense is considered a proper item in the cost of production of a manufactured product?

A. Primary product?

Q. Yes, or a co-product.

A. Oh, I would like to state there that when you say overhead, and I answer yes, I mean manufacturing overhead, not general and administrative overhead.

Q. All right, I am using overhead in the same sense that you used it in your testimony.

A. I just wanted to make sure we understood each other.

Q. Using it in that sense, you will concede in respect to joint products, co-products or by-products, overhead expense is [634] properly included in determining cost of production?

A. Manufacturing overhead, yes.

Q. And that is true whether the manufacturer has a contract to sell that product to somebody and the price is to be determined according to the cost of production or not, isn't that true?

A. That is right.

Q. And so the contract and the fact that a third party might be affected has nothing to do with it, does it?

A. Not as far as by-product accounting is concerned.

Q. Let me ask you, have you ever been to this plant in Newark?

A. No, sir, I have not.

Q. So you do not know anything about their

(Testimony of O. Kenneth Pryor.)

processes except what you have learned in court here, is that right? A. That is true.

Q. And you have been in court every day since this case started, have you not?

A. I think I have been in court all the time.

Q. All the opinions that you have expressed in your testimony were based upon the assumption that gypsum for accounting purposes is a by-product, is that true?

A. If I understand you correctly, those assumptions which I have made as to how accounting should be treated, it is in relation to a by-product.

Q. In other words, you have assumed throughout your testimony [635] that gypsum is a by-product for accounting purposes?

A. I was referring to it in that sense.

Q. And you are expressing no personal opinion of that yourself, are you?

A. I have not expressed one.

Q. No. In other words, you do not know, at least you have not expressed an opinion, and counsel did not ask you to, as to whether or not in your expert opinion, and in light of all the circumstances relating to the operation of this plant and everything else that you would have to know in order to arrive at an intelligent conclusion, whether or not gypsum is in fact a by-product for accounting purposes?

Mr. Bennett: That is argumentative, if Your Honor please.

The Court: The objection will be overruled.

A. I was not asked, as I recall it, whether in my opinion it was a by-product.

(Testimony of O. Kenneth Pryor.)

Q. (Mr. Rosenberg): Tell me if I am correctly stating what you stated in your direct testimony, that in determining cost of production of a by-product, you should include only those necessary expenses directly and solely attributable to its production and of which you can ascertain the amount with exactitude, is that right?

A. I think that is the way I expressed it.

Q. Let me ask you on what authority you make that statement. What is the basis for that expert opinion? [636]

A. I would say long experience in the profession, seeing a great many instances of account for by-products.

Q. I mean that particular language that you used. Where did you get that from?

A. The words themselves?

Q. Yes. Those are original with you, are they?

A. I do not know exactly what you mean originally with me, but I believe that that is my own definition.

Q. Let me ask you, can you refer me to any text writers or any papers or treatises by persons either being or purporting to be accounting authorities that would sustain your view that where you elect to determine the cost of production of a by-product, it is improper to include any overhead expense or indirect charges? Can you refer me to any authorities on that?

A. I do not have any specifically in mind, but I am sure there must be many like that because I

(Testimony of O. Kenneth Pryor.)

have read a good deal about accounting matters in my life and I have seen a good many [637] instances, and that is the way I have always looked upon it.

Q. You indulged in some preparation for your testimony in this case, didn't you?

A. I talked over a good many things.

Q. Did you go into your library to see if you could find anything on the subject?

A. The only thing which I really tried to find out was I wanted to check my ideas of the definition of a by-product.

Q. That is all you looked up?

A. I looked for other things but I did not immediately pay attention to the mechanical procedures, because I knew them so well. I have seen so many things on that subject, of course.

Q. But you can't recall any at this moment?

A. Specifically I would not want to say, yes.

Q. What is that?

A. I said, specifically I would not want to say.

Q. In preparation for your testimony in this case, didn't you go into your library and see if you had any works on by-products accounting?

A. I have a very limited library space for accounting books in my room and I did not go out of it for the purpose.

Q. Didn't you, Mr. Webster and Mr. Draewell collaborate for the purpose of your testimony in this case?

Mr. Bennett: I object to that question as in-

(Testimony of O. Kenneth Pryor.)

definite and uncertain. What do you mean by collaborate? [638]

Mr. Rosenberg: I will make it more certain.

Q. Didn't you, Mr. Webster and Mr. Draewell confer together and discuss the subject and discuss the testimony that you and each of you were to give in this case?

A. We conferred with each other. I don't know what you mean by discussing the testimony.

Q. Did you all agree that you were all going to state that in determining the cost of production of a by-product you should include only those necessary expenses directly and solely attributable to its production and of which you can ascertain the amount? Didn't the three of you get together and agree that that is what would be your opinions in testifying in this case?

A. We had no agreement. We discussed that definition and all of us felt that it met the case.

Q. And that probably explains the fact that you have all used precisely the same language, does it? A. I would not be surprised.

Q. In the course of your discussions, did any of you come up with a reference to any paper or treatise or authority that would support your view?

A. I can only answer that I did not. I do not know whether the others made references or not.

Q. At least in the course of their discussions with you they did not refer to anything, did they?

A. They did not.

Q. You have been sitting here ever since this

(Testimony of O. Kenneth Pryor.)

case started. You heard me when I was questioning Mr. Webster and Mr. Draewell, refer to the official publication of the National Association of Cost Accountants, didn't you?

A. I heard you refer to that book. I did not know it took on an official status.

Q. You know what the publication of the National Association of Cost Accountants is, don't you?

A. I do not know them all. I know their general publications, certainly.

Q. And you heard me mention this particular one, didn't you? A. Yes.

Q. A couple of days ago?

A. If that is the one you have in mind—the 1920 edition or something?

Q. You know that there is at least this authority on that subject? A. I do.

Q. But you have not troubled to look at it?

A. I haven't, and I do not know that I consider it an authority.

Q. You would not know until you read it, would you?

A. No, I would not. That is why I say I do not know whether I would.

Mr. Bennett: Apparently you have the only volume of that [640] in San Francisco, counsel. I have been looking through the libraries and every place I could find, including a lot of accounting offices.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: Well, I do not think anybody looked very hard.

Mr. Bennett: There is only one firm I could find and they said they had loaned their copy to a lawyer the other day.

Mr. Rosenberg: That is where I got it from.

Mr. Bennett: McLaren Goode & Company.

Mr. Rosenberg. No.

Mr. Bennett: But I defy you to find another copy in town.

The Court: You do not contend this is the only copy in town, do you?

Mr. Bennett: I have had the libraries searched, the Mechanics Library, the City Library, and my secretary has called a number of accountant firms. We finally found one firm who had it, and when they looked for it they said they turned it over to a lawyer the other day, and apparently this is the one.

The Court: It indicates the energy counsel has put in this case.

Mr. Bennett: He got the right one.

Mr. Rosenberg: I might say I got it the first time I inquired for it, and from the only source of which I inquired.

The Court: I am so limited on these matters myself, even [641] to discuss them, I felt surely there must be some treatises, texts on cost accounting.

Q. Aren't there? A. Yes.

The Court: The witness said there are.

(Testimony of O. Kenneth Pryor.)

The Witness: Yes, there are books on cost accounting, but usually the subject of by-product accounting is not treated very extensively in them. They are written for students and that sort of thing.

Mr. Bennett: When I said to Your Honor there wasn't any, I was thinking of this volume. This is the one I have looked high and low for and could not locate. Whether there are others I do not know.

Q. (Mr. Rosenberg): Did you ever read "Basic Standard Costs" by Eric A. Camman?

A. No, I have not.

Q. Have you ever heard of Mr. Camman?

A. Yes, I have.

Q. He is recognized as an authority on cost accounting?

Mr. Bennett: If Your Honor please——

Mr. Rosenberg: I am not reading anything.

Mr. Bennett: Wait. I want to repeat the objection I made the other day. This is not proper cross-examination. I can cite the Davis case and McBain——

Mr. Rosenberg: I just thought if he had read it, I would [642] refer to it.

The Court: If it was not admissible for any other purpose, it would be admissible for the purpose of testing this witness' testimony, would it not?

Mr. Bennett: The courts have not considered it proper cross-examination, Your Honor, on various occasions.

(Testimony of O. Kenneth Pryor.)

The Court: Forgetting, for a moment, cross-examination; qualifying the witness as to the weight of his testimony.

Mr. Bennett: The Courts say that that is not the proper way to do it.

The Court: I would like to be straightened out on that.

Mr. Rosenberg: I think it is proper, if the Court please. There are some decisions that hold that unless a witness has referred to a particular work in his direct examination, it is improper to read excerpts from the work to him on cross-examination.

The Court: To read it, but keeping in mind that the witness qualifies as an expert, any examination in relation to his testimony and his ability to testify should be measured and it goes to the weight of his testimony, it seems to me. If I am in error, I should like to be corrected.

Mr. Rosenberg: I think that is the rule. As I say, I think there are cases both ways.

The Court: I have followed that rule, and if I am in error I would like to be corrected. [643]

Mr. Rosenberg: I know in a comparatively recent case decided in this Circuit by the Circuit Court of Appeals, that was held to be proper cross-examination.

Mr. Bennett: What case is that?

Mr. Rosenberg: American Whaling Company v. Christensen, 93 Fed. Sec. 17.

Mr. Bennett: The vice of the matter, Your

(Testimony of O. Kenneth Pryor.)

Honor, is that it opens the door too wide to get before the Court, in unsworn hearsay form, evidence or the effect of evidence that is not evidence. I read to Your Honor yesterday the decision of the Supreme Court of the United States in the case of *Davis v. United States*:

“After a witness has once qualified himself as an expert and given his own professional opinion with reference to that which he has seen or heard, or upon hypothetical questions, it is ordinarily opening the door to too wide an inquiry to interrogate him as to what other scientific men have said upon such matters or with respect to the teachings of science thereon or to permit books of science to be offered in evidence.”

McBain has many comments on that and cites numerous cases. I do not have in mind specifically this decision that counsel mentioned, but I think Your Honor can see the harm that is done by reference to books.

The Court: I can see the abuse of it, but when a witness [644] is called as an expert witness——

Mr. Bennett: It is proper to inquire into the witness' expert basis, his training, the things that serve to qualify him or not as a witness; but Your Honor and I know in the field of science, even in the fields of law, we have people who write things in which there is a complete divergence of opinion. In fact, we will find quite frequently reports of the Supreme Court decisions 5 to 4, and we find our own District Courts of Appeal sometimes deciding

(Testimony of O. Kenneth Pryor.)

one division the case one way and the other, another, and we find in law review articles entirely divergent points of view stated, and to pick out at random here and there a statement or a book or a text or something and ask the witness, "Did you read this? This is what this says," the effect of the thing is, as the Supreme Court said, to open the door too wide to improper evidence. I think the basis for my objection is apparent from what I have said. I have no objection to counsel interrogating this witness as to his qualifications as an expert, but I do not think it is proper to do so by this particular method.

The Court: What testimony is in this record that is an abuse of the Supreme Court case that you cited?

Mr. Bennett: Your Honor has read into the record—not Your Honor, but counsel has read into the record certain statements contained in a text or a book that counsel referred to here, the same book that I told Your Honor I have searched [645] high and wide, but, so far as I know, there is only one here in San Francisco.

The Court: The question was did he agree with that.

Mr. Bennett: That is not proper cross-examination. That is what the Supreme Court has said in the Davis case and Courts have constantly said that. That is what the Courts said here. It is not proper on cross-examination to ask a witness whether——

(Testimony of O. Kenneth Pryor.)

The Court: Let us see what subject matter they were dealing with. What was the factual situation in that case?

Mr. Bennett: The expert in that case was a doctor. He was expressing a medical opinion.

The Court: Yes.

Mr. Bennett: Then counsel for the defendant starts to cross-examine him, or, as the Court said, to interrogate him as to what other scientific men had said on the same subject, and the Supreme Court said that that is not proper.

The Court: If you begin there, it would not be proper, but that is not the whole case. Hand me that case and proceed with this case. I will consult that.

Mr. Bennett: I do not want to prolong this trial. I can give Your Honor other citations, too.

The Court: I have no doubt if you search the record and the books you can get a hundred cases on each side of any question we discover from time to time. [646]

Mr. Bennett: This is a well established rule.

The Court: I do not disagree with you in part.

Mr. Bennett: Here is a leading case on it.

The Court: This is a death case:

“After qualifying as an expert I am giving his professional opinion in reference to that which he has seen or heard and questioned on behalf of defense on cross-examination, ‘You think from your experience with him, from your conversations with him, that he killed the man because he threatened his life.’ ”

(Testimony of O. Kenneth Pryor.)

That was the question in this case where you had——

Mr. Bennett: Yes, your Honor. That involves an expert opinion on the ground the doctor was a psychiatrist, or purported to be one.

The Court: Yes.

Mr. Bennett: He expressed the opinion that the acts of the individual in his mind as a psychiatrist indicated the commission of the offense. He was sought to be cross-examined by references to what some other psychiatrist may have said in some book or record as to whether or not those physical indications would be sufficient to warrant the scientific deduction that the witness is stating. The court said that is not proper.

The Court: In a criminal case under the same circumstances I would base this ruling in this case.

Mr. Bennett: Here is the general rule McBain speaks of, he is our author on Evidence in this State. Your Honor is quite familiar with him. Turn to page 293, Section 211. [647]

The Court: This is McBain on Evidence. You must have another edition.

Mr. Bennett: Here it is, your Honor.

The Court: This is an ancient edition, I am afraid.

Mr. Bennett: Here is another edition. He is the professor of law at the University of California. He has written that book.

The Court: Well, I have no quarrel with this Professor McBain at all.

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: As he states there, rather citing this Bailey case, it is proper if the witness bases his opinion upon some scientific book to cross-examine him about that book; no question about that, but this witness said he had never read this book nor heard of it, has not got it. Besides, as part of his cross-examination that book cannot be waved around and he be asked whether he agrees with what that book says. That clearly falls within the provisions——

The Court: Is there some comment you wish to make before I make an announcement, myself?

Mr. Rosenberg: There is nothing before the court. I am enjoined from any discussion. I have not asked a question, your Honor.

The Court: I am satisfied, I think, from my personal experience with you you conduct yourself in a manner that a seasoned, a well-seasoned lawyer would. You sit down there and let [648] somebody else perform for you. If there is any question about it I wouldn't have any hesitancy in striking out the testimony in relation to any testimony that went in in relation——

Mr. Rosenberg: That's right, your Honor. If there is any doubt about it I wouldn't object.

The Court: You see, lawyers have as much difficulty and get into the same positions that cost accountants and expert witnesses on cost accounting books do. I am free to say there is a difference in what the courts do. Here you have witnesses in relation to cost accounting and right from the testi-

(Testimony of O. Kenneth Pryor.)

mony in this record it shows that we are not dealing with an exact science.

Mr. Bennett: I don't know what difference there is, your Honor. I have not noted any substantial difference.

The Court: Well, maybe it is me, and my limited experience.

Mr. Bennett: Your Honor may have in mind what the witness Webster said, that he did not deal with the term "overhead" specifically, it was what was included in overhead that he objected to. I think if we go down to the point where it is time to argue I will show there is not any difference at all. He says he just does not treat it upon the terminology of overhead; some items may be listed as overhead which in fact are direct charges, but I don't recall any substantial——

The Court: Well, you won't be taken by surprise before [649] we get through. There will be a definite conflict; you are anticipating that, I take it.

Mr. Bennett: Yes, I suppose so. I have had experience in the past when we have had experts on both sides of a question, your Honor.

The Court: I have seen it frequently on both sides in dozens of cases, counsel for the plaintiff calls his witnesses and you may expect a conflict when the defense calls his. That is the reason they were called.

Mr. Bennett: Well, I don't know that to be a fact, that the defendant has any experts who will be any different from ourselves. My supposition——

(Testimony of O. Kenneth Pryor.)

The Court: You might expect anything from counsel. I don't know any more than you do about it.

Mr. Rosenberg: I was going to say, your Honor, that in this American Whaling case, decided in this Court, the court——

The Court: An opinion by whom?

Mr. Rosenberg: Denman, Stephens and Healy. This is what the court said:

“Passages from text-books were read to a witness on cross-examination and defendant assigns this as improper. This was permissible to test the knowledge, accuracy, and credibility of the witness,” as an expert witness.

The Court: To determine the credibility of the witness. [650] The test you give to the witness, I think perhaps for a limited purpose.

Mr. Bennett: What counsel has just read is nothing but a dictum statement and is not a decision by the court. I have not had a chance to read this opinion. My associate just brought it in.

The Court: In any event, you have an objection to that line of testimony and both sides will have an opportunity to present it.

Mr. Bennett: Yes, your Honor. I understand my objection runs to all of this.

The Court: To all of it.

Mr. Bennett: Without necessarily repeating it.

The Court: No necessity for repeating it. The only thing, you will be comforted by a record, and you have a record.

Mr. Bennett: Well, as I said to your Honor be-

(Testimony of O. Kenneth Pryor.)

fore, I, perhaps, am a very poor one trying a case with a record; I would rather try it with a judge who is going to decide the case in the trial court.

(Discussion off record.)

The Court: Proceed, now.

Q. (Mr. Rosenberg): Mr. Pryor, reverting again to this expert opinion of yours derived, as I understand it, solely from experience, is that it?

A. I wouldn't say solely from experience, but studies during the [651] term of 20 or 25 years.

Q. Have you ever had any experience in cost accounting for a chemical plant that starts with a common raw material and produces a number of products from that raw material, in setting up the accounting for such a chemical plant?

A. When you say in setting up the accounting, do you mean familiar with the accounting system?

Q. Familiarizing yourself or having gone into the cost accounting.

A. Of that type of plant?

Q. Yes. A. Yes.

Q. What plant was that?

A. It is a plant that is owned by one of my clients, it is a large plant.

Q. What do they make?

A. They make—the end product is chiefly ammonia.

Q. What else do they make?

A. Well, that is, practically speaking, the only one of the end products, although they do have another product which is a by-product.

(Testimony of O. Kenneth Pryor.)

Q. What is that?

A. Perhaps I can best tell you by describing the by-product. In the process of making this ammonia they first must produce hydrogen—I hope I am not getting over my head in chemistry, [652] here because I may very well be.

The Court: You will have a lot of company.

The Witness: They first introduce natural gas into the plant and the natural gas is, I believe, heated and subjected to pressures and in that process they produce the hydrogen, which in turn is used to produce the ammonia. When they heat and treat the natural gas it removes by precipitation, or some process similar to that, carbon, and the carbon is processed into briquets and sold for fuel, I believe it is. Of course, the carbon coming off there represents to them the by-product from this main and primary object which they have in mind of producing the ammonia.

Q. (Mr. Rosenberg): That carbon is produced by the heating of the mother gas, is that it?

A. I would rather not specify.

Q. At any rate,—maybe I am becoming too specific—have you ever had any experience in setting up the cost accounting for a chemical plant for a number of products out of a common material where any one of the products was covered by a contract that required you to determine the cost of production in order to determine the sales price of the product?

(Testimony of O. Kenneth Pryor.)

A. You mean the contract for a by-product?

Q. Well, if you want to call it a by-product, all right.

A. I believe the case I had that comes to that particular analogy would be in the case of the Oil Refineries who during [653] the war furnished a product, I believe it was known as butalenes, I believe they called it butalenes, and it was taken into a portion of a plant and made into a butadiene, and the butadiene is a raw product used in making artificial rubber, synthetic rubber. In that case the butalenes were in the making of a by-product and the refining company had a contract with Rubber Reserve Corporation, to pay them for the butalenes that they put out.

Q. And was the price dependent upon the cost of production?

A. To go on further——

Q. No. Can't you answer just "yes" or "no," was it or was it not?

A. The price of the butalenes, or the whole operation?

Q. The butalenes.

A. I believe it was based on a price per unit with some sort of an escalator clause which was tied around an index, crude oil posted price.

Q. Oh, I see. Does your Honor wish to recess now?

The Court: We will take a recess.

(Recess.)

Q. (Mr. Rosenberg): Mr. Pryor, with refer-

(Testimony of O. Kenneth Pryor.)

ence to by-product accounting, cost accounting, as I understand it it is your opinion that it is improper to include any indirect charges, any overhead or any charges that are not ascertainable with exactitude; is that right? [654]

A. I think my full definition was, any necessary expenses that were directly and solely attributed to the by-product that can be ascertained were proper charges to it.

Q. Would that exclude anything that could not be directly related to anything that had to be allocated on the same basis?

A. Yes, that is correct.

Q. Of course, that is not true of a co-product or joint product, is it?

A. No, that is not true of a co-product or joint product.

Q. And in a co-product or joint product it is common practice to allocate among the various co-products or joint products certain types of expenses which cannot be directly related to the respective products, is that not true?

A. That is common practice. I think I would like to clear up one point which I think I may have been confused on, one of the questions, just before the recess. I wished at that time to make this point, my answer to the question when you compare two accounting periods that were—where the change between the two accounting periods may have an effect upon an outside party will make a difference in my thinking as to overhead. Now, I would like

(Testimony of O. Kenneth Pryor.)

to make this point: If a company allocates overhead to its products it has a certain leeway or choice, you might say, for its own purposes, whereas if an outside party is involved then there is a great responsibility put on them to use proper bases for allocation, and to allocate [655] proper items and to allocate it on a basis which is comparable between periods. In other words, there is a greater responsibility on the company computing cost of manufacture where an outside person is involved than if they were just doing it for their own internal purposes.

Q. That is not a matter of accounting. That is a matter of common business integrity, isn't it?

A. Yes, but I think—I answered the question there once before.

Q. That would apply whether you are talking about a by-product or a joint product or a single product, wouldn't it?

A. I am assuming always here that you are talking about the allocation of overhead for your internal purposes as opposed to where somebody else might be involved.

Q. For instance, you testified in reference to this Exhibit 15, I don't know whether I understood your last statement, but when you came to this matter of fuel it shows 1 cent in the second column and none in the first. You don't know whether that results from a change in accounting or whether it results from a change in circumstances, do you?

A. That is to say whether it was a change in

(Testimony of O. Kenneth Pryor.)

accounting or that fuel was changed to some other fuel?

Q. Yes; you don't know what that was?

A. No, I don't know what the facts are.

Q. In other words, you will concede, will you not, that if a [656] change occurs in one period of necessity by reason of a change in circumstances, a change which did not occur in the prior period, it is nevertheless a proper charge, isn't it?

A. Well, that wouldn't be the only basis as to whether it were a proper charge, but assuming for a moment that whatever we are referring to is a proper charge, then I think you have got to put the two periods in making a comparison on a comparable basis.

Q. Would you say this, Mr. Pryor, and indulging in one of your own presumptions that in the second period we had a cost for fuel and power that did not occur in the previous period, that you would adjust the previous period to make it appear as if the expense had occurred?

A. I cannot conceive of just exactly that situation. Why wouldn't it have occurred in both periods? Perhaps I could answer—

Q. Well, I am asking you to assume there is some valid reason why it occurred in the second period and did not occur in the first period, such being the case, I am asking about the propriety of including it in the second period.

A. If it was a new expense that was directly attributable and had not been incurred before, I don't see anything wrong with doing that.

(Testimony of O. Kenneth Pryor.)

Q. Let's assume that you have an expense that was incurred in the prior period but was put in a different account, and [657] then in the second period it appears for the first time in a new account, I believe you stated it that you would eliminate that from the second period.

A. Not because of the account that it was classified in, but because of the nature of the item.

Q. Well, at any time if you find an expense had occurred for the first time in the second of two comparative periods before you could determine whether or not that should be eliminated from the second period you would have to find out whether a similar expense is in the first period but in a different account?

A. If you had the expense, for example, in a direct charge account in the second period and that was a necessary expense and properly attributed to it, but you had that same expense in some other account in the first period of the two periods, you ought to put the two periods on a comparable basis, either put it in both places or take them out.

Q. Say in the first period you have it in account No. 3 and in the second period you have it in account No. 5, and say in the second period it appears you had that charged in account No. 5, but that you did not charge it in account No. 5 in the preceding period, but it was in account No. 3 in the preceding period, nobody is being done an injustice under those circumstances; isn't that true?

A. I don't know what account No. 3 and No. 5

(Testimony of O. Kenneth Pryor.)

are, but if [658] account No. 3 was a direct charge account and account No. 5 is a direct charge account I don't believe there would be any point to the question.

Q. No, it wouldn't make any difference under those circumstances, would it?

A. It is the nature of the item.

Q. That's right. With reference to cost accounting for by-products is it your expert opinion that the method which you have testified to the court as your opinion of the proper accounting method to be followed is the only proper accounting method for by-product cost?

A. Very frequently companies do not even determine costs of a by-product.

Q. I am talking about where you are determining costs.

A. And you are determining cost of manufacturing?

Q. That's right, cost of production, cost of manufacture.

A. It is the only proper basis of accounting which, I might say, I conceive. It is backed up by common sense, that is to charge the cost to that by-product which you are out of pocket because you produce that by-product.

Q. Wouldn't it be just as logical—what is the philosophy in back of that reasoning? Wouldn't it be just as logical to say in case of a plant that is making 10 joint products that if you are going to discontinue one product and if in that event there

(Testimony of O. Kenneth Pryor.)

were certain expenses that would continue [659] notwithstanding the discontinuance, but in a lesser and unascertainable amount, that, therefore, you may include in the cost of producing that product any of these overhead or indirect charges?

A. That is not quite the philosophy. The philosophy of joint product accounting is that you are in business for the purpose of making all your joint products and they should, of course, stand a reasonable proportion between the products as to the cost of manufacturing.

Q. Then consistent with that would you say in the presumption you must apply that if Westvaco is in the business of making bromines and gypsum, no magnesium, you would have to include all of your proper production costs in determining the cost of production of each of these products?

A. When you use the word "proper," I don't know exactly what you mean.

Q. I mean the same items of cost of production that are proper for the inclusion of a manufactured product.

A. Direct charges to any particular product, that may be so, but when it comes to overhead I think it is something different.

Q. Well, overhead is proper to include in the cost of production of a main or co-product, isn't it?

A. It depends on what you mean by overhead again.

Q. I am using it in the sense you used it.

A. In all of them, as I understand the type of

(Testimony of O. Kenneth Pryor.)

overhead we [660] are talking about here, which is on one of the exhibits—I have forgotten the number——

Q. No. I am talking about overhead in the sense you used it. I don't like to have to go over it again. I understood you to say that overhead in the sense that you used the term is a proper element in the cost of production of a primary, main or a joint or co-product.

A. I meant to say, if I said that, manufacturing overhead.

Q. That is just what I mean, too. I understood you to say just a moment ago that if that plant is set up for the purpose of producing a number of products, then you would distribute those charges, including overhead, against the products that are produced; didn't you say that?

A. The primary product, but not the by-product.

Q. Well, if a plant is put up for the purpose of producing several different products, would you consider any one of them a by-product?

A. Very possibly.

Q. How do you determine whether it is or it is not?

A. A by-product is a product that is produced incidental to the main manufacturing process which was not the primary purpose of the plant to produce, the by-product. It was the primary purpose of constructing the plant to produce all products exclusive of the by-products, because that product would not be a consideration alone. Any company,

(Testimony of O. Kenneth Pryor.)

in starting to go into [661] business figures all sources of its income, everything it can conceive that might have a bearing on whether it will build the plant, or not, but that depends always on the products.

Q. Well, what is your basis, again, when a thing is a by-product, or joint product, or co-product?

A. I think the definition which is most generally used of a by-product is a product which is produced as an incidental to the production of a main or principal product, primary product. That definition, I think, has already been testified here before, and I think I can subscribe to it, that there are two types of by-products, the type that you can sell the minute it is separated from the main process, and if you have to do something to it before you can sell it.

Q. In other words, I understood you to state that if something comes off of the production line incidental to the production of another product, that it is ipso facto a by-product; is that true?

A. I do not believe I know exactly what you mean, because if the production line, if it is merely produced as an incidental to the production source it goes on whether you want to produce it, but if it comes off automatically, you can't help hardly to produce it, then I think it is a by-product.

Q. Even though perhaps it was one of the motivating considerations that caused you to produce the plant, to construct the plant, you would nevertheless consider it a by-product, would you? [662]

(Testimony of O. Kenneth Pryor.)

A. As I said, when you consider whether or not you want to construct the plant you take in what you think you can get for all your products, by-products and joint products, and perhaps for even outside engineering services you might perform for somebody, you take all the income into consideration and you add up all your expenses, and if you think you can make an over-all profit you build the plant.

Q. And you would consider after you had built your plant then you as an expert, certified public accountant, if you were called in to set up the books for that company you would say, "Now, anything that comes off incidental to the production of another product in this plant is a by-product and therefore we will keep our cost records only in so far as direct labor charges and direct charges directly attributable to that product, would you?"

A. That would be good accounting and accepted accounting to generally follow.

Q. In other words, you would do that as an expert if you were called in to a plant that was constructed to turn out a number of products, and if you went into the plant and you found out that one product, regardless of how important it was to the manufacture came off the production line incidental to the production of another product, then you would employ the by-product accounting practice to which you have testified, and would not treat it as a primary or a joint product? [663]

A. I think when a company builds a plant it usually understands, or it understands the process

(Testimony of O. Kenneth Pryor.)

that it is going to use for the product right from the very beginning, and I think it would be proper accounting to treat it as such.

Q. I see. Let me ask you this, Mr. Pryor, with reference to this shipping expense. I will ask you to assume that over at this Westvaco plant at Newark, California, we have a shipping department, and out of this department we ship magnesia products, we ship from the shipping department, and as far as the direct labor, here we have two products, and I will refer to them and say we keep time cards for that direct labor. Assume for the proper conduct of that shipping department we have to have a superintendent and we have to have a foreman, we have to have a foreman assistant, and those men devote their time to that shipping department, to the shipping of those two products, gypsum and magnesium. Now, I want you to tell me as an expert public accountant whether it is your contention that the magnesia should bear all of the cost of this shipping department, the foreman, the foreman assistant, the shipping clerk, and include in that hypothesis the assumption that the volume of gypsum shipped, the quantity and tonnage of it exceeds the magnesia. Now, tell me that.

A. If those people who cannot be assigned directly as spending all their time on gypsum are working in that plant, and would continue to go on whether or not you produced gypsum, then I [664] think they should be charged to the primary product, magnesia.

(Testimony of O. Kenneth Pryor.)

Q. Let's assume that we discontinued magnesia and their services would be necessarily continued purely for the purpose of handling gypsum.

A. And that is all the plant made?

Q. Let's assume it.

A. Then it would be the primary product.

Q. What is the logic, the magic attached to the word "by-product" that where men are actually devoting services to the handling of a product and merely because you attach a label to it, that you should not charge it with expenses that would be properly chargeable to it if you attached a label main product to it. Will you explain the logic of that?

Mr. Bennett: I think that is argumentative, your Honor. The witness has answered it. If there is any further answer to be given——

The Court: You may answer.

A. I think the logic goes back again to my illustration of how a man determines whether or not he is going to process and sell a by-product. If it costs him out of pocket 9 cents to process it, and he can sell it when finished for ten cents, then it is good business to do so, but if by allocating indirect expenses, which would go on anyhow whether or not he was producing that product, and other expenses of an overhead nature which would go on anyhow whether he produced the [665] product, he would have had 2 cents of indirect expense, making a total cost of 11 cents, then he would not produce the product, so it is just common sense that you

(Testimony of O. Kenneth Pryor.)

only charge in making up your mind whether to produce or not the amount you are out of pocket for it. [665-a]

Q. (Mr. Rosenberg): It is only common sense you start with the assumption that there is some reason for employing a different method in accounting for by-products and joint products?

A. You start with the assumption that it is a by-product.

Q. Let me ask you this: Let us assume in that case that you know that if you discontinue gypsum your miscellaneous shipping expenses of the nature that I have mentioned will be reduced but you can not tell exactly in what amount. Then you would likewise under those circumstances say that, notwithstanding that you know that gypsum is getting the benefit of the services, that those employees are necessary in order to get the gypsum out of the plant and to ship it to the buyer, nevertheless gypsum should be charged with no part of that cost, is that your expert opinion?

A. If one of those shipping clerks could be dispensed with, if you discontinued, then I think that clerk is not an indirect expense but a direct expense and his salary ought to be put in there in the first place.

Q. How can you tell it is a direct expense? He is working on both gypsum and magnesia.

Mr. Bennett: I think it is further argumentative, counsel. The witness has stated if the discontinuance of gypsum would eliminate one of the men,

(Testimony of O. Kenneth Pryor.)

that means that that man was working presently on gypsum and his salary or wages, social security and other taxes should be charged against gypsum.

Mr. Rosenberg: I have withdrawn the question, Mr. Bennett.

Q. If instead, then, of having handled the shipment of gypsum and magnesium out of one shipping department, Westvaco should set up separate shipping departments and have a superintendent in the magnesia department and one in the gypsum and a foreman in each department, then would you say that that category of charges in the gypsum shipping department would be proper expenses to include in the cost of producing gypsum?

A. If they meet my test, if necessary, then I would say they are because they are devoting their full time to it.

Q. You apply the same theory and reasoning to all of these other indirect charges that you mentioned, is that true? In other words, let us take the laboratories at the plant. Under our contract we have to bring that gypsum up to certain specifications and therefore it is necessary for us to sample and test and analyze the gypsum, and those services are done in a laboratory in which other products in the plant are likewise tested and analyzed because it is economical to have only one laboratory instead of three or four. Now, is it your expert opinion that although that service is absolutely necessary in order to produce and deliver the gypsum pursuant to this contract, that it is an improper charge to

(Testimony of O. Kenneth Pryor.)

gypsum merely by virtue of the fact that you have to allocate it in the same manner that you would allocate it if it were considered a joint product? [667]

A. My answer to that would be presuming always that this is a laboratory man who is engaged in controlling, we will say, the production within the gypsum plant and he devoted all his time to that plant, he would be out there as direct——

Q. No, that is not my question at all. Let us say you have got a laboratory. A. Yes.

Q. And let us say we have two expert chemical technicians in there and we have to test our magnesia products and we have to test our gypsum products, and when we are making bromine we have to test our bromine products, and it would be uneconomical to have a separate laboratory for each product, but it is indispensable to the proper production and delivery of gypsum under this contract that we have a laboratory in which to perform these services. Do I understand that you as an expert dispute the propriety of allocating some fair production of that charge to gypsum?

A. If you could not dispense with the services of one of those two technicians by the discontinuance of production of a by-product, then I do not think the by-product should stand any part of the expense.

Q. But if we set up a separate laboratory and it would require the services of one technician to

(Testimony of O. Kenneth Pryor.)

do this work for gypsum, you would not question that, even though it is a by-product?

A. If that is a necessary expense, I think it is a direct one. [668]

Q. The sole basis of your objection is it has to be allocated and can not be determined directly, is that it?

A. I would not say that that is the sole basis.

Q. You admit that the service is a proper service to include in the cost of production if it could be determined on a direct basis, but you dispute the propriety of including any cost for the service if you have to allocate it, isn't that true?

A. I think the heart of the thing is, Are you out of pocket any or would you be out of pocket any—let me start that answer over again. The question is, Are you out of pocket any?

Q. That is not my question, no. I am asking how and on what logical basis you as an expert accountant hold the opinion that under the circumstances that I mentioned it would be improper to charge anything to gypsum because of the fact that you would have to allocate it on some rational basis.

A. To begin with, I do not think allocations are proper, and the other answer is, the other reason is, that you would not cut your expenses down any by discontinuing the production of gypsum. Therefore I think the entire expense should be charged to the principal product and not gypsum.

Q. And if we had a laboratory where we were

(Testimony of O. Kenneth Pryor.)

testing ten different products, if we discontinued any one of them, the expense of the laboratory would continue anyway, wouldn't it?

A. Are you talking about joint products now?

Q. Joint products, yes. [669]

A. As far as I know, I guess so.

Q. Do I understand you to say as a general proposition, as an expert accountant, you do not favor allocations?

A. No, I did not say that.

Q. I must have misunderstood you. I do not know whether I asked you this. If so, I would like to ask it again: Isn't it true that it is not uncommon in instances where, by reason of a contract or other business considerations, it is determined necessary to keep records and compute costs of production of a by-product, that it is not uncommon, even though you may not agree with it, to include the same elements of cost as you do in the case of a joint product or a co-product?

A. Are you speaking of direct costs only now or all costs?

Q. No, everything you would include in the case of a joint product.

A. I do not think it is common.

Q. Do you not think it is. And I believe you said before these opinions that you hold are purely your own personal opinions based upon your own experience, is that true, and what studying you have done from undisclosed sources, is that right?

A. That is all my opinion can be based on.

(Testimony of O. Kenneth Pryor.)

Q. With reference to overhead again—I do not know whether I understood your testimony or not, but I want to get it clear: Assuming that overhead would be a proper item in the cost of production of gypsum, then there is no doubt that in making [670] comparisons between one period and another you would include overhead in both periods, wouldn't you?

A. Manufacturing overhead, yes.

Q. With reference to this Exhibit 15, when you were asked about supervision, which appears to be allocated, and you said you do not agree with the allocation, you said you did not believe there should be any arbitrary allocation of supervision, what did you mean by that?

A. To by-product gypsum?

Q. Yes.

A. I do not believe that supervision should be charged to by-product gypsum.

Q. What did you mean by arbitrary, or didn't you attach my significance to the use of that term, or were you just saying what you have said with reference to everything else, that if you have a plant superintendent, a general management and everything that has to do with the operation of the gypsum operation, as well as the other processes in the plant, that it is your opinion that unless they can be directly related and determined without allocating, you do not believe they are proper to include in cost of production, were you referring to the same principle when you mentioned supervision?

(Testimony of O. Kenneth Pryor.)

A. That we just referred to with regard to laboratory, for example, yes.

Q. You are just following out, being consistent in that [671] opinion, is that right?

A. That is right. I think that I said that I do not think arbitrary allocations where another party is concerned are proper either.

Q. Also—I will be through in a couple of minutes, I hope—Your Honor—with reference to this supervision, you have mentioned the footnote 5 and directed attention to the fact that there was a different percentage allocated in one period than in the other period.

A. Yes.

Q. And you said that that indicated to you that there was a change in accounting, is that right, in accounting method?

A. I do not believe I said that.

Q. What did it indicate to you? What was your objection to that?

A. I do not know that I took exception to it because I was eliminating the entire item. I do not know how those percentages were determined.

Q. If it were proper to allocate supervision, and if by reason of some change in circumstances and consistent with the same basis of allocation, it resulted in a different percentage in one period than in another, you would have no objection to that if you were in favor in the first instance of allocating it, would you?

A. You say in the same circumstances? [672]

(Testimony of O. Kenneth Pryor.)

Q. No, I say by reason of change of circumstances.

A. Well, changes in circumstances might and, assuming it is proper to allocate items, changes in circumstances might lead me to adopt an entirely different basis of allocation.

Q. When would you do that?

A. For example, supposing you were taking over the labor and using that as a basis, and in the first of the two periods you had a process you were going through with very little direct labor and in the second period you had a process where you had a lot of labor in your primary product or your secondary product or any other product, it might be some other basis besides a direct labor basis would be appropriate.

Q. For the second period?

A. For the second period, but I would like to make this clear, that you have got to be consistent as between the two periods. Now, if you use a basis in one period, you should use the basis in the other period.

Q. So if you are going to be consistent, if you are using direct labor in the first period, you would have to use direct labor in the second period regardless of what result occurred, wouldn't you?

A. I do not believe I understand that exactly.

Q. Well, I do not think you do either, Mr. Pryor. As I understood you a moment ago, you said that if you used direct labor in the first period, then in the second period, through change [673]

(Testimony of O. Kenneth Pryor.)

of circumstances, there was either a great deal more or a great deal less, you might use a different basis of allocation, and I had understood you to say that one thing you insist upon is consistency.

A. The application of consistent accounting principles.

Mr. Bennett: I do not think that that is his testimony, Your Honor. I think what the witness said he did not understand was counsel's question, not that he did not understand the subject matter.

Q. (Mr. Rosenberg): What is your testimony now under the circumstances you just suggested yourself, where you use direct labor in one period and then by reason of change in circumstances you in your good judgment feel that some other basis of allocation should be used in the second period? Would you use it or wouldn't you use it?

A. And there is a change in circumstances?

Q. Yes. A. Then I might change my basis.

Q. Then you might change?

A. Why, yes.

Q. I am sure you would. Also with reference to this business here on the blackboard, you have stated that in your opinion there should be no bittern charged to gypsum, is that right-

A. As I understand it, that is the——

Q. That is your sea water? [674]

A. That is the sea water; then I do not believe that any part of that should be charged to the cost of producing the by-product gypsum.

Q. That again is premised entirely upon your

(Testimony of O. Kenneth Pryor.)

conception of gypsum, that is, upon your assumption of gypsum as a by-product, is that right?

A. That is right. If it were a joint product it might be something else.

Q. (The Court): How can you produce gypsum unless you have the bittern?

A. That, of course, I do not know the chemical processes here.

Q. I do not either, but as a practical matter——

Mr. Bennett: I can give Your Honor this example: How can you produce sawdust without logs?

The Court: How can you what?

Mr. Bennett: How can you produce sawdust without a log in a lumbering operation? Lumber is the primary product.

The Court: Eliminating that, I had in mind the method you were attributing costs here. It might be interesting to you to know that I worked in the largest sawmill in America about 40 years ago.

Mr. Bennett: I know, and I know Your Honor has had other experience, too.

The Court: I never got far from the business operations. The central question here I asked, and I have my own reasons for [675] asking, we begin with bittern here.

Mr. Bennett: Yes, Your Honor.

The Court: You could not produce gypsum if you did not have the bittern.

Mr. Bennett: You could mine it out of the hills. You mean in this particular operation?

(Testimony of O. Kenneth Pryor.)

The Court: This operation.

Mr. Bennett: That is true, Your Honor, just as you have to have a peach to produce a peach pit. But the point the witness has made, and all our witnesses so far, and the position that we take is that where the gypsum is not the primary product——

The Court: I understand.

Mr. Bennett: And whereas in this case, when we did not meet their demands, they actually stopped producing gypsum, they went ahead and used the same quantity of bittern to manufacture the end product, in such a situation it is improper, both from the standpoint of accounting and the standpoint of common reasoning to assess as against the by-product the raw material which is necessary for the production of the main product, whether or not the by-product is produced. In this case, if it please the Court,——

The Court: You start with a by-product. The bittern itself is a by-product.

Mr. Bennett: Of course it may be a by-product so far as the [676] Leslie Salt Company is concerned, but it is not a by-product is so far as the manufacture of Westvaco is concerned. It is its main product, just as seeds from a cotton gin may be the by-product from the gin, so far as the gin operator is concerned, but it is not a by-product when it comes into the plant, say, of an oil refining corporation. In that situation the cottonseed is the main raw material and out of the main raw material

(Testimony of O. Kenneth Pryor.)

they make oil, which is the primary product, and the shells from the seed are oftentimes made into cattle feed, which is a by-product.

The Court: I understand. Is that all from this witness?

Mr. Rosenberg: I have one more question.

Q. Directing your attention again to this Exhibit 15, your attention was directed to sulphuric acid, and you stated that from the fact that there is a charge in the second period and none in the first period—did I understand you correctly to state that that would indicate to you that there had been a change in accounting practice?

A. Yes, it does indicate that.

Q. It does? Can't you conceive that there might have been some other circumstances that contributed to that?

A. Yes, perhaps sulphuric acid was not used at all in the first period and was used in the second period in the operation all the way from the beginning of the plant to the point where magnesium oxide is delivered. [677]

Q. It might result from a change of circumstances rather than a change of accounting practice, isn't that true? A. Why, certainly.

Q. You do not want the Court to understand that it is your expert opinion that that indicates a change in accounting practice, do you?

A. Oh, no, I do not know the circumstances of why the item is put in on a sheet.

Mr. Rosenberg: That is all.

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: I could probably finish with the witness unless Your Honor plans an adjournment at this moment.

The Court: It depends on you. How much time do you wish? I do not want to hurry you but the Judges have a meeting at 4:00 o'clock.

Mr. Bennett: The witness can come back in the morning and we can finish in a few minutes then.

The Court. All right.

(Thereupon a recess was taken until tomorrow, Friday, December 19, 1947, at 10:00 a.m.)

Friday, December 19, 1947, 10:00 o'clock a.m.

O. KENNETH PRYOR,
resumed the stand;

Redirect Examination

Q. (Mr. Bennett): Mr. Pryor, during your cross-examination you referred to a client of your firm, a chemical industry engaged in the production at one of its plants of ammonia, and incidental to that operation there was produced a product, as you described it, of carbon.

A. That is the basic raw material from which the by-product is produced, carbon, and it is processed from that point on.

Q. The main or primary product produced at that plant was ammonia?

A. That was the end product, yes.

Q. And the carbon was produced as an incident to that manufacture by the heating of the natural

(Testimony of O. Kenneth Pryor.)

gas from which the end or primary product was made?

A. It was separated from the hydrogen which was contained in the natural gas. In other words, there was a point of separation of that carbon in the process.

Q. The removal of that carbon being necessary to manufacture from the raw material, natural gas, the primary product, ammonia, is that correct?

A. That is correct.

Q. And then this residue carbon was further processed and made [679] into some other product, was it?

A. Yes. It was used primarily, I believe, in the production of what they call briquets, which were used for fuel.

Q. What was the treatment so far as accounting costs of production of the briquets that were made from the carbon?

A. They only charged to cost of production of the briquets those direct expenses which they were out of pocket in processing the raw carbon.

Q. State whether or not there was considered as part of the cost of producing those briquets any allocation of indirect or overhead, or so-called overhead?

A. No, there was not.

Q. Was any part of the raw material, the natural gas, charged to the production of this carbon?

A. No, there was not.

Q. That method of accounting and the determination of the cost of production of the by-product

(Testimony of O. Kenneth Pryor.)

briquets was in accordance with the opinions that you have given here as proper determination of cost to be included in the cost of production and the cost of manufacture of gypsum?

A. That is correct.

Q. During the trial, both on your cross-examination and the cross-examination of other witnesses, reference has been made by counsel to a booklet or publication containing several parts, pamphlets, bound under the title "National Association of [680] Cost Accounting," Volume 1, December, 1919, to December, 1920, and you testified you had not seen or read that volume.

A. That is correct.

Q. After it was first referred to in the courtroom did you make any effort to find or locate it?

Mr. Rosenberg: I object on the ground it has been asked and answered. I asked him and he said no, he did not consider it was necessary.

The Court: He may answer in the interest of time.

A. I personally made no search for it. I know a search was made.

Q. (Mr. Bennett): Do you have this volume in your library or office? A. No, I do not.

Q. Do you know that to be a fact?

A. I know that to be a fact.

Q. State whether you agree with this statement, Mr. Pryor—and I am now reading from page 14, Volume 1, No. 7, dated August 20th, entitled, "Accounting for By-Products," in this particular volume:

(Testimony of O. Kenneth Pryor.)

“If the by-product is of so little value at the time it arises that it normally would be dumped, it often is manufactured and sold practically without profit in order to eliminate the cost of dumping. In that case only the cost of getting the by-product into salable state should be charged to it.” [681]

Mr. Rosenberg: May I see what you are reading from, Mr. Bennett?

The Witness: That is theory of by-product accounting which I have been describing. That is my understanding of what good by-product accounting was.

Mr. Rosenberg: Let the record show that counsel is reading from this official publication of the National Association of Cost Accountants, Volume 1, No. 7, dated August, 1920, and entitled, “Accounting for By-Products.”

Mr. Bennett: That was stated, counsel, and apparently it appears in the form of a pamphlet together with other pamphlets which have been bound together in this so-called 1920 volume. That is the same book that you were referring to and reading from when you examined the other witnesses and referred to in your cross-examination of this witness, isn't it?

Mr. Rosenberg: That is right.

Q. (Mr. Bennett): Mr. Pryor, you stated to the court your opinion as to the rule that should be applied in determining cost in a situation involving the manufacture of a by-product, where not only the manufacturer, for his own purposes is con-

(Testimony of O. Kenneth Pryor.)

cerned, but also where there is concerned the interest of the purchaser in the matter of any actual advance in cost of manufactured of the by-product between two twelve-month periods. Will you state to the court the reasons in your opinion for the application of such rule? [682]

Mr. Rosenberg: I submit that is not proper re-direct examination. My recollection is the witness was asked precisely the same question on direct examination.

Mr. Bennett: I asked him, your Honor, and he has given your Honor the rule; on cross-examination he was cross-examined at length——

The Court: In the interest of time I will allow it so we may get through.

A. In the first place, I think the logic back of my theory of determining the cost of manufacture of a by-product is based on common business sense. It is logical. It makes sense that you only charge to it those out-of-pocket expenses that you have, and you do not try to allocate to it expenses that would go on anyhow, whether or not you produced or went ahead and processed your by-product. For that reason I think the rule is a common sense rule as well as good accounting. But in the situation you described, I think you have got further reasons for not making allocations to the by-product cost. In the first place, if you make an allocation to a by-product you will have to adopt certain presumptions and hypotheses and assumptions, and they do not come up with something that is actual when you

(Testimony of O. Kenneth Pryor.)

do that. I might illustrate what I mean there by putting it this way:

Suppose we use direct labor as a basis of allocating some indirect or overhead item, and let us assume that the ratio of [683] the direct labor in the manufacture of the primary product remains constant as related to the by-product in the two years, the first and second years which is affecting your computation. But assume that you increased your overhead in the engineering department, we will say, by putting on a new man, a new engineer, who was perhaps working on designs or working on processes, even after the point of separation of the by-product, but at least not working on gypsum, and you needed that new engineer for your other or primary product. You would get an artificial increase in your per ton cost of production of the by-product there because of this allocation basis, where actually there was no increase in the cost of production of the by-product. It is bookkeeping, or it is a theory and not actual.

I think there is the further reason also that could be demonstrated, and that is when you get away from the plant operations of the by-product and you go to a more remote point and you have various and sundry kinds of overhead, new product research, accounting, donations, mine explorations, and such things as I have seen on this list of so-called overhead, and you use a direct labor basis for allocation, or, for that matter, any basis of allocation that I could think of, if you tried to apply the

(Testimony of O. Kenneth Pryor.)

same basis of allocation to every one of these items, the total, you are bound to have an artificial figure. It is based upon assumptions. You make an assumption when you distribute New York overhead to West Coast. You make [684] some further assumptions when you consider transferring the West Coast expense to the plant, and you make further assumptions when you allocate the overhead within the plant to a principal product and a by-product, and I think it becomes so remote and so hypothetical that I do not believe there is good justification for saying in any way that it is actual, that it represents an actual increase, and I think those are the principal reasons I have in mind.

Q. Can you determine, according to accounting methods, the actual increase in the cost of manufacture—and I repeat again the word “actual”—where it involves of allocating, say, indirect and overhead items by any such basis as the relation of labor charges, direct labor charges of the primary product as compared to the by-product?

A. When you adopt an assumption you immediately leave actualities, and I do not think that it does represent actual.

Q. Mr. Pryor, if the problem was to compare two periods, and if in the second period a changed accounting method is adopted due to changed circumstances, let us say, would or would not any re-computation of costs for the first period be necessary in order to make the apportionment a true one aside from any other circumstances involved?

(Testimony of O. Kenneth Pryor.)

A. I think when you change the basis of allocation between periods you more or less have changed the rules of the game in the middle of the game.

When, for example, as I think has been done in this instance, you change the method of allocating an indirect expense from a value basis to a tonnage basis between years, I think you have changed the rules of the game, and I think you either have to play the game under the rules of the first half or the second half, and you should in that case either have them on a tonnage basis both times or a value basis both times, whichever is appropriate, but you should not change.

Mr. Bennett: That is all. Thank you, Mr. Pryor.

Recross-Examination

Q. (Mr. Rosenberg): Mr. Pryor, I just want this record to be straight: By your answer to the last question you did not mean to conflict with your testimony of yesterday, where you conceded that if a new or different charge results in one period due to a change of circumstances, that did not occur in a prior period, you would not dispute the propriety of including the charge, nevertheless, would you?

A. I believe we were talking about fuel oil at that time, were we not?

Q. As an illustration, yes.

A. As an illustration, fuel oil, and I believe the assumption was that we substituted fuel oil for some other fuel for some necessary purpose. Perhaps we could not get natural gas and we had to

(Testimony of O. Kenneth Pryor.)

use fuel oil. Then I think, of course, you have a situation in which you are entitled to make a change between [686] periods, because you have used something in place of something else.

Q. That is right. Let me ask you this: Where you are making a half dozen co-products in a plant, in determining the cost of each of the co-products you would charge to each of the co-products the direct charges, would you? A. Yes.

Q. And then as to the plant overhead and miscellaneous or indirect plant charges, you would allocate those between the six products, would you?

A. Those are the manufacturing costs, yes.

Q. You would use as a basis for allocation such allocation factor as you in your good judgment considered most likely to arrive at an equitable result approaching the actual, would you?

A. Well, I might use many factors, applying a different factor to different types of manufacturing costs, of course. I do not want the record to appear that I meant you would have one factor and apply it to all kinds of expenses regardless of their nature.

Q. No, but you would have to allocate on some rational basis, and the reason you would have to allocate is because you cannot determine the actual, isn't it?

A. That is true with regard to such things, as, we will say, plant watchman.

Q. And plant superintendent? [687]

A. Yes.

(Testimony of O. Kenneth Pryor.)

Q. And bookkeeping and accounting?

A. Just a moment. The bookkeeping and accounting, as regards the cost of accounting for production within the plant, that would be true.

Q. That is what I have been talking about.

A. I do not mean sales accounting, in other words. I just wanted to make it clear.

Q. But you have to allocate those because you can't determine the actual?

A. That is the practical way most people follow who have nobody else to worry about but keeping their own books.

Q. Yes, and if you have somebody else to worry about you would still have to use the same book-keeping method. You would have to allocate on some basis, wouldn't you?

A. Yes, but I think your responsibilities for allocating to a particular product, when you are involved in only one particular product, would become a great deal greater.

Q. I won't argue with you on that, although it has nothing to do with what I have asked you. I will ask you this simple question, and eliminating now the question of by-product. A. Yes.

Q. To determine the cost of production of a co-product you have to allocate certain charges because you cannot determine them actually, is that true? [688]

A. That is generally speaking done.

Q. And that is no objection to the accounting, is it? A. No, it is not.

(Testimony of O. Kenneth Pryor.)

Q. And so if I understand your reasoning, your reasoning is that it is improper in the case of a by-product because, according to your expert opinion, you should not charge anything to a by-product that cannot be determined with exactitude, is that right?

A. I think that is true, but when I was talking about the further reason here I was making an assumption that you make an allocation to a by-product, and the further reasons were based upon the question as put to me, that there was somebody else involved.

Q. And you said the reason you did not think it was proper is that in order to make allocations you have to indulge in assumptions which are assumptions rather than actualities, isn't that what you said?

A. That is because the word "actual" was put to me.

Q. You have to indulge in the same assumption when you are making allocations in the case of co-products, don't you?

A. That is what you generally do.

Q. But that is no objection to doing it. You have to do it as a matter of expediency because there is no better way to do it, is that right?

A. For that purpose I have no objection at all.

Q. Let us take the case of this carbon deal you were talking [689] about. In that case, as I understood your testimony yesterday, there was a contract to sell that carbon, but the cost or the price

(Testimony of O. Kenneth Pryor.)

to be received for the product was not dependent upon the cost of production, was it?

A. No, there was no contract to sell that carbon. I do not believe I testified to that.

Q. Isn't this true, Mr. Pryor, that accountants follow the practice of keeping accounting records in the most practical form and in the simplest form that is expedient for the purpose of the particular client that you are serving?

A. That is correct.

Q. Sure, so that where you have an operation of that kind it did not make a particle of difference to the firm that was producing this carbon whether they kept any cost records of this carbon, did it?

A. I would say no, although I do not want to quibble with you about the thing.

Q. Don't hesitate to quibble with me.

A. I can conceive of a situation where it might make a difference to them. In other words, they have to determine whether to make it or stop making it.

Q. Having determined to make it, they could have elected not to keep any cost records?

A. That is right.

Q. And it would not have made a particle of difference to the [690] buyer or seller?

A. No.

Q. So the fact is whether another person is interested should control your accounting depends on from whose viewpoint you are looking at it, whether it is the buyer's or the seller's viewpoint?

(Testimony of O. Kenneth Pryor.)

A. In that particular case there was nobody involved and they did it the way I think it should be done where somebody is involved.

Q. You do not think it makes any difference whether somebody else is involved?

A. No, I do not think it makes any difference so far as my general principle is concerned, but I think I have pointed out if you are going to make allocations, if there is some basis, which I do not believe is proper, but if you are going to, they are compelling reasons beyond the others.

Q. Let me ask you on this carbon deal, how did they treat the proceeds of the sale?

A. I do not recall whether they credited them to the cost of the principal product or took them into sales.

Q. You do not know?

A. I don't remember, no.

Q. Did you set up that accounting system?

A. No, I merely approved it.

Q. But it is possible they were following the simple expedient [691] of treating the recoveries from the sale of the by-product as a cost in the production of the main product, is that true?

A. I don't know.

Q. You say you don't know. Perhaps they did that?

A. What I meant by that was I do not know how they were treating the proceeds from the briquets. I know how they determined their cost of production.

(Testimony of O. Kenneth Pryor.)

Q. But it is possible that they treat the proceeds from the sale of the briquets as a reduction in the cost of production of the main product?

A. I think if they treated it on that basis, what they would do would be to take the sales of the briquets, match against them the cost assigned to the briquets, and credit the net to the principal product.

Q. But the fact of the matter is you do not know just what they did in that respect, do you?

A. I am not sure. I did not look it up, no.

Mr. Bennett: You are talking about what happens to the money received from the sale of it?

Mr. Rosenberg: That is right. That is a matter of accounting in a firm where it does not make any difference how they keep their account records.

Q. Let me ask you this: In that operation was the amount of carbon produced dependent upon the amount of the end product produced? [692]

A. The amount of carbon produced is dependent on the amount of hydrogen produced, and I presume, therefore, you might say in effect that is what the effect is.

Q. What do you mean "in effect"? That is actual, isn't it?

A. They may go out and buy their hydrogen, you see.

Q. Then they would not be making it. I am talking about what they did in this plant. Is it true the amount of carbon they produced was de-

(Testimony of O. Kenneth Pryor.)

pendent directly upon the amount of hydrogen that was produced? A. I would say so.

Q. Getting back to this official publication of the National Association of Cost Accountant, have you read this? A. No, I haven't got it.

Q. Counsel picked out a little paragraph here. You scanned this yesterday, didn't you?

A. I do not know what you mean by "scanned it."

Q. I gave it to you.

A. You gave it to me and I handed it to Mr. Bennett, I think.

Q. You got nothing out of it? I know you sat here looking at it for a few moments. Did you get anything out of it? Did you glean from it that the article states there are three methods of by-product accounting?

A. I can truthfully say I did not see that.

Q. You did not. Well, let me ask you if you would agree with this statement—and I might say for the record, your Honor, [693] what the witness was referring to should be read in its context, that the article does discuss three different methods of by-product accounting, and the little excerpt Mr. Bennett read to the witness is under the heading, "Advantages and disadvantages of the second method, and refers exclusively to the discussion of the advantages and disadvantages of the second method.

Will you agree with this statement:

"In many plants the tendency is to charge as little cost as possible to the by-product on the theory

(Testimony of O. Kenneth Pryor.)

that it is entitled to the free use of the shop's equipment. Nothing could be more fallacious. No portion of a factory's output should be favored over any other. The output should be charged with its legitimate cost. This can be done correctly only under—"

I will stop it at that point. Do you agree with that statement?

A. May I read that again? I have difficulty following.

The Court: We will take a recess in this matter. I have some other matters.

Mr. Rosenberg: I will leave that book with the witness during the recess.

(Recess.) [694]

Q. (Mr. Rosenberg): Mr. Pryor, I read a statement to you and asked you if you would read it. I don't recall whether you answered it or not.

A. No, I did not answer it.

Q. Do you recall what the statement was?

A. I would like to have the book in my hand because the statement covers several sentences.

Mr. Bennett: So the record will be straight, Mr. Rosenberg, you are now directing the witness to a statement under the heading "Advantages and Disadvantages of the Third Method."

Mr. Rosenberg: That's right.

Mr. Bennett: The statement I read had to do with the "Advantages and Disadvantages of the Second Method."

Mr. Rosenberg: Yes.

Mr. Bennett: There are three methods, as I un-

(Testimony of O. Kenneth Pryor.)

derstand, suggested by whoever wrote that book.

The Witness: Well, in the first sentence, if I may read it.

The Court: You may.

The Witness: "In many plants the tendency is to charge as little as possible to the by-product on the theory that it is entitled to the free use of the shop's equipment."

I do not know, of course, what thought the author had in mind when he said, "as little cost as possible." I suppose you could say a dollar is as little cost as possible. When he [695] uses "free use of the shop's equipment," perhaps he is talking about repairs there which, for example, if it were direct repairs, I would include. I disagree with the theory that you can charge as little as possible; I don't think that is very scientific.

Q. (Mr. Rosenberg): Go ahead.

The Witness: "Nothing could be more fallacious." Well, I agree with that. "No portion of a factory's output should be favored over any other." Well, I think perhaps that is true. I don't know what he means by "favored." I guess you read the next sentence, too. "Each output should be charged with its legitimate cost." I agree with that. I think my definition of what legitimate cost is—I don't know what his definition might be.

Q. As counsel pointed out to you, the author was talking about the "advantages and disadvantages of a third method" and the third method is described as follows: "Under the third method by-

(Testimony of O. Kenneth Pryor.)

products generally are charged with (1) material at an arbitrary value, if necessary; (2) labor expended on by-product after it is separated from the main product; (3) an equitable proportion of overhead; (4) a proper share of selling and administrative expense when these items are applied on the various products or class of products on the basis of manufacturing cost." [696]

Now, having in mind that that is the method that was referred to——

Mr. Bennett: Is that the third method?

Mr. Rosenberg: Yes.

Mr. Bennett: That is the third method.

Mr. Rosenberg: And under the same subject heading, "Advantages and Disadvantages of the Third Method," I will ask you if you agree with the statement, "It should be remembered that the manufacturer of by-products usually expects to receive for them a price which will cover the cost of labor and overhead and allow a reasonable profit." Would you agree with that?

A. That he——

Mr. Bennett: Labor and overhead.

The Witness: Overhead.

Mr. Rosenberg: It should be remembered that the manufacturer of by-products usually expects to receive for them a price which will cover the cost of labor and overhead and allow a reasonable profit."

Do you agree with that?

A. I don't think that that would be the determining factor in his mind. I think he would meas-

(Testimony of O. Kenneth Pryor.)

ure his out-of-pocket expense against what he could get for it, not all the overhead and everything else.

Q. So you would not agree that a manufacturer of by-products usually expects to receive a price that will cover his labor [697] and overhead and allow him a reasonable profit; you do not think that is true?

Mr. Bennett: That is the vice of using a text like this. He speaks only of labor and overhead and our testimony has shown here we include many others and in addition to labor—it is probable that the author lists under overhead a number of these items that we consider direct charges.

The Court: The witness may answer.

A. I do not agree with that statement. As a matter of fact, in glancing through the article it seemed to me that the author was talking about advantages and disadvantages of three methods and more or less saying that you can do it according to your convenience if it suits your internal purposes. I don't believe doing something for your own convenience should govern if you are trying to compare two periods for the purpose of determining the actual cost of production.

Q. (Mr. Rosenberg): What difference has the comparison of two periods got to do with what is proper accounting; if it is proper accounting you will use it and therefore your two periods will be comparable.

A. Let me repeat, I don't think what might be convenient for a person's internal purpose besides his own to be served.

(Testimony of O. Kenneth Pryor.)

Q. I will ask you where you derive that out of this article, but before I do that I am going to direct your attention to the [698] final sentence in the article and ask if you agree with it: "On the whole, however, the third method is more logical and it gives information which is of vital importance in the administrative control of the business."

Do you agree with that?

A. No, I do not.

Q. Will you show me what portion of what you refer to in stating you think the author said it is a matter of convenience?

Mr. Bennett: Just a moment. May I have the witness' answer to that given back there a little bit?

(Record read.)

Mr. Bennett: I don't think that is the answer I wanted.

Mr. Rosenberg: I asked him, Mr. Bennett, if he agreed with the concluding statement which which states: "On the whole, the third method is more logical and it gives information which is of vital importance in the administrative control of the business."

Mr. Bennett: Did you ask him whether he agreed with that?

Mr. Rosenberg: And I believe he stated that he did not.

Mr. Bennett: He did not agree. Is that correct?

The Witness: Yes.

(Testimony of O. Kenneth Pryor.)

Q. (Mr. Rosenberg): May I ask you, you made a comment earlier that you gathered from the article something about a matter of convenience. I would like you to show me what you were referring to. [699]

A. I don't know that I used the words of that article now. I said I felt that that was the sense of the article which refers to various ways of doing it and gives advantages and disadvantages of those several ways.

Q. Well, then, it is a fact there are various ways that it can be done in accordance with good accounting practice; isn't that what the author states?

Mr. Bennett: You asked him whether the witness considers that or whether the author——

Mr. Rosenberg: No; it is separate and apart from the book.

Q. In other words, there are several different accounting practices that can be employed and are employed in cost accounting of a by-product, but you have given us what, in your opinion, you consider the proper method.

A. That is correct, but I would like to point out again the definition which I was talking about here. You might adopt some method which would be for your own convenience, but it might not be an appropriate one in figuring the cost of production if you had somebody else concerned.

Q. But it is true, is it not, disregarding for the moment the fact that a third person might be affected, you would not say that it is improper ac-

(Testimony of O. Kenneth Pryor.)

counting practice for a manufacturer of a by-product to treat it as a co-product and employ the same accounting methods as he would for the co-product? [700]

A. For his own convenience, he could do it that way, he may do it any number of ways.

Q. Yet you would not say that that was poor accounting, would you?

A. I don't know what you mean "poor accounting," exactly. I think, for example, for a financial statement purpose I wouldn't object probably.

Q. Let us go back to the matter of direct charges. I am going to use the shipping department as an illustration again and ask you to assume this: Assume that this plant over here is making two products, one of the products is gypsum and one of the products is magnesium; you may assume also that the product gypsum is a by-product and assume that the company has a contract to sell all of the magnesia produced in the plant to a third party at a fixed price, we will say, \$46 a ton; the contract provides that in addition to the \$46 a ton, this third party who is the buyer, will pay the cost of shipping the magnesia and placing it on board the cars and you are employed by the buyer and you go into the plant and you see that they have a shipping department which is handling only these two products, magnesia and gypsum, and you find that the quantity of gypsum being shipped is at least as great as the quantity of magnesia, and you find in the shipping department

(Testimony of O. Kenneth Pryor.)

they have a superintendent and a foreman and a shipping clerk, and you find that in keeping their records of costs in the shipping department, they [701] charge all of the superintendent's salary, the foreman's salary, the shipping clerk's salary to the magnesia and nothing of it to the gypsum, and the buyer sent you over there to find out whether or not they were properly determining the amount of shipping expense that he should pay for getting this magnesia out of the plant and to him in accordance with the contract.

Under those circumstances would you go back to your client and tell him that this was perfectly proper, that he was being properly treated in having all of these supervisory expenses charged to him and none to the gypsum, notwithstanding that the quantity of gypsum being shipped out of the plant was at least as great as the quantity of magnesia?

A. On the assumptions that you have made, the gypsum is a by-product and your expenses you just referred to, your supervision would go on whether or not they shipped that gypsum and I don't see what basis I would have for objecting to its inclusion in the cost of the main product, magnesium.

Q. So under those circumstances as an expert certified public accountant and in service to your client, the buyer, you would go back and you would say they have a shipping plant over there and they are handling as much gypsum as magnesia, but they are saddling the magnesia for all of the su-

(Testimony of O. Kenneth Pryor.)

pervisory expenses, but as an expert public accountant I tell you it is all right, go ahead and pay it.

A. I might tell him about it, but I think I would tell him [702] I don't think he has a basis for objection because the other is a by-product.

Q. Of course, if you considered gypsum as a co-product then you would go back and tell your client that it was improper?

A. If everything had been put to the one co-product that he was involved in and not the other, yes, I would tell him that.

Mr. Rosenberg: I think that is all.

Further Redirect Examination

Q. (Mr. Bennett): Mr. Pryor, was there anything in this article, in this 1920 publication, that you read in the three methods of accounting for by-products being set up, one of which methods, at least one statement concerning that method I read you agreed with, was there anything at all about the situation of a third person or someone other than the manufacturer itself being concerned with the determination of actual cost of production?

Mr. Rosenberg: Just a moment. The witness said he has not read the article so I don't imagine he can say.

The Court: In any event, it did not embody, the testimony did not embody a third person.

Mr. Bennett: The point I wanted to bring out, this article, Your Honor, dealt only with the three methods available to a manufacturer and did not

(Testimony of O. Kenneth Pryor.)

deal with the question of where there is a special problem, which we have involved here.

Q. What method would you consider the best and the most accurate [703] method of accounting for a by-product to determine the actual cost or actual cost of manufacture or production of a by-product?

A. Are you referring to the article that I read in that book?

Q. Yes. Well, never mind that. I say of all the methods that might be employed, assuming there are more than one, which method, either in this book or that otherwise might be suggested to you, do you consider the best method and the most appropriate method for the determination of actual costs of manufacture or actual cost of production of a by-product?

A. I consider the method whereby you do not charge any cost to the cost of manufacture of a by-product unless they are necessary expenses directly and solely attributable to that by-product or those which are ascertainable.

Q. Would any method of accounting that would allow or include indirect costs which would continue even if the by-product was not manufactured but in a less degree but an unascertainable degree, make possible a determination of the actual cost of manufacture?

A. I do not think so.

Q. Would any such method of allocating these indirect charges that would have gone on in any event and in any lessening degree which are unas-

(Testimony of O. Kenneth Pryor.)

certainable, furnish any basis for the determination of the actual advance in the cost of manufacture of the by-product in one twelve-month period over the preceding twelve-month period? [704]

Mr. Rosenberg: Well, I will submit that is completely irrelevant. He is testifying as to what he says is the best accounting practice. We assume that if we use the same method in two periods, if it is the proper method, it is proper for comparative purposes, and if it is improper, it is improper for comparative purposes, and he admitted himself that this business of comparison does not enter into it.

Mr. Bennett: You missed the nature of my question.

Mr. Rosenberg: Then I withdraw the objection.

(The question was read by the Reporter.)

A. (The Witness): I don't think so.

Q. (Mr. Bennett): Would a method suggested as the third method in this book where the purpose of the manufacturer is to determine in relation to his sales as well as his production and operation which would involve all the factors by way of allocations relating to those matters, provide a basis whereby the actual cost of manufacturing of the by-product would be obtained?

A. I do not think so.

Q. As I understood the testimony on recross examination that where conceivable some variations of accounting may be permissible for a manufacturer to suit his own purpose.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: Please don't summarize the witness' testimony. If you want to ask a question, go ahead. I object to this practice of telling the witness what he said and then [705] asking him if that is right.

Mr. Bennett: You have done it constantly.

Mr. Rosenberg: I have been doing nothing but cross-examining up to this point. I have not had a witness on direct. We are here for the eighth day, now. That is my purpose, it is not your purpose.

The Court: I think you asked for four days to try this case. You asked for four days, did you not?

Mr. Bennett: Yes, Your Honor.

The Court: Proceed.

Q. (Mr. Bennett): State whether or not, Mr. Pryor, a system of accounting relative to the cost of production of a by-product that might suit the purpose of the manufacturer would be appropriate where a third person or another person is concerned in that determination and where it is necessary or desirable to determine the actual cost to the manufacturer.

Mr. Rosenberg: I object on the ground it calls for an opinion and conclusion of the witness on a matter that is not a proper subject of expert testimony. It depends upon the contract between the parties in this particular case as to what is or is not proper; by reason of the fact that Pacific is going to be affected, I don't know what he is supposed to be a witness on now, the morals or business ethics or what, but I will—

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: Counsel, you know that is not a proper statement to make. As I understand the matter, the witness [706] stated, or, at least, I understood his statement was that a system of accounting might be appropriate to the purposes of the manufacturer but inappropriate for the actual determination of cost where a third party is involved.

Mr. Rosenberg: If you so understand, it is obvious you don't have to ask him, you don't need to ask him the question.

Mr. Bennett: I thought I could get it in one direct answer rather than to spell it out in a number of answers. I did it for the benefit of the Court. If Your Honor does not think it is necessary, I won't take the time.

Mr. Rosenberg: I withdraw my objection.

The Witness: May I have the question?

(The question was read by the Reporter.)

A. (The Witness): Not necessarily so.

Mr. Bennett: That is all. Thank you.

The Court: Step down.

Mr. Bennett: If Your Honor please, I would like to offer in evidence at this time and read into the record paragraph 10(e) of Defendant's answers to plaintiff's interrogatories:

"Prior to January 1, 1944, all overhead expense was allocated on the basis of operating labor and repair labor expense. Commencing January 1, 1944, and until January 1, 1946, general overhead ex-

pense was allocated on a combined supervision and operating labor basis. Maintenance and engineering costs were [707] allocated on a repair labor basis. Process control and control laboratory costs were allocated on a direct basis with the balance of the costs of these two departments pro-rated over the direct allocation. Commencing January 1, 1946, and during the period from that date to and including June 30, 1946, the same procedure was followed with the exception that general overhead was allocated on a combined operating and repair labor basis. In prior years miscellaneous shipping expenses allocated to gypsum was allocated on a dollar value basis. In June, 1945, miscellaneous shipping expense was charged and allocated to gypsum on a tonnage basis. The above changes were brought about upon the advice of competent accountants for the purpose of improving the book-keeping and accounting records of defendant as related to all products produced by defendant, including gypsum, and to accomplish uniformity of accounting practices between the various units of the defendant company."

Now, I offer that, Your Honor, not as evidence of the truth of the facts stated, but the claim of the company as to what it did and why. Plaintiff rests, Your Honor.

Mr. Bennett: I might say this before I rest, it may well be, as Your Honor has suggested, that the plaintiffs have taken too long in presenting the case here, but I consider the evidence that has been produced here in this case important and a somewhat

unusual litigation, I consider it was not irrelevant [708] or improper.

The Court: Let me give you the right state of mind. If I am not here in this case, it would be some other case. I have to keep in mind the volume of work that we have here in litigation. I put two or three cases over so we could go on with this and dispose of it.

Mr. Bennett: I understand that. I certainly did not intend my statement in any way to mean criticism.

The Court: No, no. If it ever comes to the time that the courts can not be criticized, that will be a sad day.

Mr. Bennett: Far be it from me to criticize any purpose that Your Honor had in mind.

The Court: I never did indulge in the thought that there was any perfection among judges, any more than any other human beings.

Mr. Bennett: That attitude of mind is always a compliment to the individual. I wanted to say, Your Honor, that I think that technically we have gone forward with evidence here that we were not required to do in these classes of case, declaratory judgment actions or declaratory relief suits in which controversies are involved, the determination of which is to be declared by the court, the plaintiff only has the burden of proving the situation that a controversy exists and if not the burden of proof, at least the burden of going forward with the evidence shifts to the other party. The burden in this case of [709] proving what was cost of pro-

duction and manufacture and what are the actual increases was upon the defendant. I will cite Your Honor cases for that, but I will not do it at this time. We thought our position could be made as clear as we could in this chronology and what we thought would be an orderly fashion. If Your Honor desires any authorities on this, each of my points, I will present them.

Mr. Rosenberg: I might say, Your Honor, I am going to disagree entirely with that position of counsel, so I think it might be well to have his authority at this time. It might save argument later on. Counsel has stated to the Court that all that is necessary for a plaintiff in a declaratory relief suit to do is to show that there is a controversy and then the burden of going forward with the evidence is shifted to the other side. My understanding is directly to the contrary, that a person who comes in to court on a suit for declaratory judgment has the burden of proof and he continues to have it throughout the trial, and it may very well be that the position of the parties will be directly reversed by reason of the fact there is a suit for declaratory judgment.

In other words, let us assume a controversy on an insurance policy. If an action were brought on the policy it would be for a beneficiary to bring the suit and carry the burden of proof as to whether or not the insurance company is liable, but if the insurance company elected to avail itself of the [710] benefit of the declaratory relief procedure and comes into court, their positions are entirely

reversed and it becomes the burden of the insurance company to show that it is not liable on the policy, whereas in an action at law on the policy it would be the burden of the beneficiary to prove the insurance company was liable. If counsel has any authorities on those points, I would like to have the benefit of them now. I would like to look at them during the noon recess.

Mr. Bennett: I don't want to do that, counsel, if it is not necessary. Perhaps I should after hearing any statement—I was anticipating a motion that you may not make. I want to say now if we had the burden of proof we have established a prima facie case on the facts now before the Court.

We rest.

The Court: What is your motion?

Mr. Rosenberg: I am going to move for a judgment, Your Honor. I don't think I can argue with him a minute and a half before 12:00 o'clock. I would suggest that we adjourn until 2:00.

The Court: Be prepared, then, for that motion.

Mr. Bennett: Will counsel state his motion now?

Mr. Rosenberg: I am going to ask for a——

The Court: So the other side will be in position to meet it, state it. [711]

Mr. Rosenberg: I will make a motion for a judgment in favor of defendant upon our affirmative defenses, if the Court please, that the contract on its face is invalid for uncertainty. I believe the

evidence that has been adduced by the plaintiff shows conclusively that it is.

Mr. Bennett: Is that the scope of your motion?

Mr. Rosenberg: That's right. I will elaborate a little on it.

Mr. Bennett: We will be prepared to meet that, Your Honor.

The Court: Recess until 2:00 o'clock.

(Thereupon an adjournment was taken until 2:00 o'clock p.m.) [712]

Friday, December 19, 1947, 2:00 o'clock p.m.

The Court: You may proceed.

Mr. Rosenberg: If Your Honor please, before I proceed with the motion, I would like to renew my motion to strike Exhibit 5, which was admitted subject to motion to strike, and which Your Honor may recall is a letter written under date of June 5, 1936, which is approximately seven months prior to the execution of this contract by Mr. Barrows, who was the then president of California Chemical Company, to the Pacific Portland Cement Company. At the time this letter was introduced I objected to it on the ground it was incompetent, irrelevant and immaterial and would come within the parol evidence rule because the obvious purpose of offering it was to prove that the parties intended or had an agreement that was contrary to that which was expressed in the written document.

(Motion argued.)

The Court: The offer is made in relation to paragraph 11. I will limit the testimony to paragraph 11 and I will allow it.

Mr. Bennett: That is, you do not grant the motion to strike?

The Court: No, the motion to strike will be denied, but I want it known I am limiting this testimony to paragraph 11.

Mr. Bennett: I have no objection, Your Honor, to considering the whole letter in relation to its contents. [713]

The Court: I limited the testimony, so you won't be misled now, to paragraph 11.

Mr. Rosenberg: I think, if Your Honor please, if I understand Your Honor——

The Court: I asked counsel to indicate the purpose of this offer.

Mr. Rosenberg: Yes.

The Court: He picked up paragraph 11, made an argument and contended it went to the weight of the testimony. On that basis I am allowing it.

Mr. Rosenberg: At this time, if the Court please, the defendant moves for a ruling on its affirmative defenses 3 and 4, the affirmative defense to the first cause of action, which are incorporated by reference in the other causes of action as set forth in the complaint.

(Motion argued.)

The Court: I am prepared to rule at this time. For the purpose of the record, the motion will be denied at this time. You may renew it.

(Thereupon an adjournment was taken until Tuesday, December 23, 1947, at 10:00 o'clock a. m.) [714]

Tuesday, December 23, 1947, 10:00 o'clock a.m.

STANLEY H. BARROWS,

called as a witness on behalf of the defendant, being first duly sworn, testified as follows:

Q. (The Clerk): Will you state your name?

A. Stanley H. Barrows.

Direct Examination

Q. (Mr. Rosenberg): Where do you live, Mr. Barrows?

A. I live in Carson City, Nevada.

Q. You formerly resided in San Francisco, did you?

A. Yes.

Q. You were formerly connected with the California Chemical Company, were you?

A. I was president of the California Chemical Company.

Q. When, approximately, was that corporation created?

A. I believe the record will show that it was incorporated in 1923.

Q. In what business was that corporation engaged?

A. Production, principally, of magnesium chloride.

Q. Did it operate a plant?

A. Yes, it had a plant at Chula Vista, California.

Q. That plant was engaged primarily in producing what?

A. Magnesium chloride.

Q. From what material was the magnesium chloride produced?

(Testimony of Stanley H. Barrows.)

A. It was extracted from salt bitterns. That is the residue, [715] the liquid residue which accrues in the manufacture of solar salt.

Q. In other words, that is bittern, is it?

A. Bittern.

Q. The end product in that plant at Chula Vista was what? Magnesium chloride, did you say?

A. Correct.

Mr. Bennett: What is the purpose of all this counsel, if I may ask?

Mr. Rosenberg: It is preliminary, Mr. Bennett.

Q. Did the California Chemical Company subsequently construct a new plant at a different location?

A. It constructed a chemical plant at Newark, California.

Q. Is that the same plant, that is, the same location as the plant presently conducted by the Westvaco Chlorine Products Corporation?

A. Correct.

Q. When was that plant first constructed at Newark?

A. I believe the first operations began about 1930 or 1931.

Q. What was the nature of that operation?

A. We extracted principally bromine from the bitterns.

Q. At the time that you first started operations at Newark, California, was that the only product produced, the bromine?

A. Yes, at that time.

(Testimony of Stanley H. Barrows.)

Q. For how long did that continue?

A. Well, it continued from that time up to the present. [716]

Q. No, I mean the situation where the only product being produced was bromine.

A. Well, it continued until we constructed what we termed Sea Water, Major Sea Water Plant. That is what the name was. In that plant we produced magnesium oxide, gypsum and lime.

Q. When was that plant constructed, the so-called Sea Water Plant?

A. As near as I can recall, the construction of that began in the spring of 1937 and it went into operation I think about December of the same year, or perhaps January, 1938.

Q. So do I understand that from some time approximately in 1930 until some time toward the end of 1937 the principal operation of the Newark plant was the recovery of bromine from bittern?

A. That is right.

Q. During that period of time, after the bromine was recovered from the bittern, what was done with the bittern?

A. I believe it was released back into the bay, or wasted.

Q. When did the California Chemical Company first consider going into the production of magnesium and gypsum?

A. When did they first consider it?

Q. Yes.

A. Well, they considered it for a number of

(Testimony of Stanley H. Barrows.)

years prior to the time this plant was built, at various stages of pilot planting.

Q. What do you mean by "pilot planting"?

A. A pilot plant is a small scale plant which is put into operation [717] to check laboratory findings in a small manufacturing operation.

Q. Would you say it is in the nature of an experimental plant?

A. An experimental plant.

Q. When did California Chemical first start pilot planting, as you term it, the production of magnesium and gypsum?

A. I could not give the date. It first started back in Porterville. We shipped the bitters down in tank cars. That was the early work. And then it was transferred on a larger scale to the plant at Newark, and that would be, as near as I could remember, that plant started about 1935, the first part of 1935.

Q. Then during what period did you continue the experimental operation in the pilot plant regarding the production of magnesium and gypsum?

A. That operated something over two years before we began construction of the Major Sea Water Plant.

Q. When you speak of the Major Sea Water Plant, can you tell me whether that is the present plant of the Westvaco Chlorine Products Corporation at Newark that you are speaking of?

A. That is.

Q. That is exclusive of the bromine plant, is it?

(Testimony of Stanley H. Barrows.)

A. Correct.

Q. What experimental work or what exploratory work did you do in this pilot plant in connection with the production of gypsum?

A. I could not tell what the exact operations were, but we did [718] develop a process to make a good grade of gypsum. That was one of the purposes for which the pilot plant was constructed.

Q. What investigation did you make as to the marketability of the product?

A. After the process had been adopted or developed, we took the gypsum made in that pilot plant and shipped that to various users of gypsum in order to determine whether that product which was made in the pilot plant would be successful in their own commercial scale operations. In other words, it is a checking of the quality, the usability and the suitability of the gypsum.

We also carried on—we had tests made in commercial scale plants for construction purposes, using gypsum for, for instance, plaster, cement blocks, roofing slabs. We also had it tested for soil treatment, agriculture soil treatment. There are large quantities of gypsum used in the treatment of soil. We checked all of those with our pilot plant-made gypsum and received satisfactory reports.

Q. What effect, if any, did the results of these tests and explorations have upon your plans for this new so-called Sea Water Plant?

Mr. Bennett: I think that is leading and suggestive, incompetent, irrelevant, and immaterial, if your Honor please.

(Testimony of Stanley H. Barrows.)

The Court: The objection is overruled. You may answer.

The Witness: You say I may answer? [719]

The Court: Yes.

A. Well, it had a very important bearing, because that is exactly what these tests were made for. We would not go ahead and put a very large sum of money into a new plant without having products that we expected to make tested in commercial operations. For instance, our present contract, the Pacific Portland Cement Company, tested our stuff in their commercial scales at Redwood City and approved the material, and that is when our negotiations began, after they found it was satisfactory for the manufacture of cement.

Mr. Bennett: I move to strike out the witness' answer as volunteer and self-serving.

The Court: Read the question and answer.

(Question and answer read.)

The Court: The question and answer may stand. Proceed.

Q. (Mr. Rosenberg): You mentioned the contract. Can you tell me whether or not the construction of the Sea Water Plant at Newark, California, was commenced before or after the contract between Pacific Portland Cement Company and California Chemical Company was entered into?

A. The plant was not started until after we had entered into a contract with Pacific Portland Cement, assuring the sale of our product.

Q. Let me ask you, are you a chemist, Mr. Barrows? A. No. [720]

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: I do not suppose, Mr. Bennett, there is any necessity for me tracing through the California Chemical Company to the Westvaco Chlorine Products Corporation? We are agreed that Westvaco is the successor of the California Chemical Company?

Mr. Bennett: The pleadings and your statements so far have indicated that. I do not see that there could be any question about it.

The Court: Let the record so show. Have you entered into a stipulation in that respect?

Mr. Bennett: Yes, your Honor. I think our pleadings state that the defendant Westvaco has succeeded to all the rights and obligations of California Chemical Company.

The Court: Very well, proceed.

Q. (Mr. Rosenberg): Mr. Barrows, you are familiar, are you, with the contract which is the subject-matter of this litigation?

A. In a general sense, yes. I have run through it.

Mr. Rosenberg: At this time, if the Court please, I would like to offer in evidence the original contract which is the subject-matter of the suit. There is a copy of the contract attached to the complaint, and it admitted in the answer. My only purpose in offering the original contract is to show that it is contained in the legal back of Pillsbury, Madison & Sutro. I imagine that can be stipulated and there will be [721] no need of putting the contract in. Is that true, Mr. Bennett?

Mr. Bennett: The copy you have shown me has a back on it of the Pillsbury, Madison & Sutro firm,

(Testimony of Stanley H. Barrows.)

but there is something very unusual about it, because it would appear that the back had been perhaps on some other document and had been removed. I do not know how that can be explained. I suggest, counsel, if that is your only purpose, you might have the document further identified.

Mr. Rosenberg: Yes.

Q. Mr. Barrows, I show you what purports to be a contract dated January 29, 1937, between Pacific Portland Cement Company and California Chemical Company, and ask you if you recognize the signature of William N. Williams.

A. Yes, that is his signature.

Q. And he was an officer of California Chemical Company at the time this contract was entered into?

A. Yes, he was vice president.

Q. Have you seen this contract before, the original? A. Yes, I have seen this.

Q. Are you in a position to state whether the document, when you first received it, bore the back that is contained on it?

Mr. Bennett: I think, counsel——

Q. (Mr. Rosenberg): Did it have a back on it?

A. No—— [722]

Mr. Rosenberg: Is there any question about this? Your own Mr. Colton testified that it was Pillsbury, Madison & Sutro.

Mr. Bennett: Just a minute, counsel.

Mr. Rosenberg: You are trying to raise an implication, to which I take exception, Mr. Bennett, that this back has been switched, when you know

(Testimony of Stanley H. Barrows.)

of your own knowledge, and your own client told you, that Pillsbury, Madison & Sutro prepared this contract, and you raise a nasty implication like that, and I resent it.

Mr. Bennett: All right, you can resent all you want, counsel, and I resent the statement you made here, too.

The Court: Keep in mind gentlemen, the holiday season is here and I won't be comforted by any sharp controversies.

Mr. Bennett: I think this was a little hasty. Counsel knows I was not charging him with anything. It is just another example of what has gone on several times before.

The Court: Proceed, gentlemen.

Mr. Rosenberg: You will have Mr. Colton back, will you, or has he left?

Mr. Bennett: Yes.

Mr. Rosenberg: He left?

Mr. Bennett: He is not here now. I can have him back if you desire.

Mr. Rosenberg: Is he in town? [723-4]

Mr. Bennett: No, he is up in Nevada. I told him not to come back until he heard from us.

Mr. Rosenberg: I will ask that this be admitted.

The Court: Let it be admitted and marked.

(The document referred to was thereupon received in evidence and marked Defendant's Exhibit G.)

(Testimony of Stanley H. Barrows.)

DEFENDANT'S EXHIBIT G
AGREEMENT

This Agreement, made this 29th day of January, 1937, by and between Pacific Portland Cement Company, a California corporation, hereinafter called "Pacific," a party of the first part, and California Chemical Company, a Delaware corporation, hereinafter called "California," party of the second part.

Witnesseth:

Whereas, California contemplates the erection of a plant located on Canal Head at Newark, California, primarily designed to produce magnesium oxide in its various forms, which plant will produce as a by-product substantial quantities of gypsum, and

Whereas, Pacific is desirous of purchasing from California certain of the gypsum produced at said plant;

Now, Therefore, the parties hereto, in consideration of the mutual promises and covenants herein contained, promise and agree as follows, to wit:

(1) California agrees that it will sell and deliver to Pacific, and Pacific agrees that it will purchase and receive from California, the entire output of by-product gypsum produced by California at its said plant in excess of California's requirements for use or sale of gypsum for chemical, pharmaceutical, or scientific purposes, which requirements of California shall not exceed four thousand (4,000) tons per annum. It is the intent of this agreement that Pacific will purchase from California, and California

(Testimony of Stanley H. Barrows.)

will sell to Pacific, all gypsum produced at said plant which may be available for any use for agricultural, building, or construction purposes, or any other commercial purpose other than for chemical, pharmaceutical, or scientific purposes.

(2) This agreement shall apply to all gypsum produced at said plant up to January 31, 1962; provided, however, that at any time during the first two (2) years of this agreement, upon the giving of written notice by Pacific to California, this agreement may be canceled by Pacific, and that at any time after the first two (2) years Pacific may cancel this agreement on the giving of one year's written notice to California.

(3) Pacific agrees that it will purchase and accept shipments of gypsum so produced in approximately equal monthly quantities. California agrees that on or before the fifteenth day of each month it will notify Pacific in writing of the amount of gypsum which it proposes to produce during the succeeding calendar month, and Pacific shall have the right to refuse to purchase and accept in excess of two thousand (2,000) tons in any one month, such refusal to be exercised in writing on or before the first day of the calendar month during which gypsum in excess of two thousand (2,000) tons per month is to be produced.

California further agrees that it shall give Pacific three (3) months' notice in writing of its intention to produce in excess of twenty thousand (20,000) tons of gypsum in any one calendar year, and Pacific shall have the right to refuse to purchase and

(Testimony of Stanley H. Barrows.)

accept in excess of twenty thousand (20,000) tons in any one calendar year, such refusal to be exercised in writing within thirty (30) days after receipt of notice from California.

In the event that Pacific shall exercise its right to refuse to purchase and accept in excess of two thousand (2,000) tons in any one month, or twenty thousand (20,000) tons in any one year, then and in that event California shall have the right to sell the amount so refused for any purpose whatsoever.

(4) Pacific shall pay California for said gypsum two and eighty hundredths dollars (\$2.80) per net ton of two thousand (2,000) pounds loaded bulk on board cars at the plant of California at Newark, California. Payments shall be made on the fifteenth day of the month for gypsum loaded during the preceding month.

(5) In the event that any gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) tendered to Pacific hereunder shall not be within two per cent (2%) in gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) content of, or if it shall not conform to, the chemical analysis and specification attached hereto, marked Exhibit "A," and hereby made a part hereof, then and in that event Pacific shall have the option as to any such gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) either to (1) refuse to accept and pay for such gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$), or (2) accept such gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) and pay therefor ten cents (10c) per ton less than the price provided for in paragraph (4) above for each per cent which the said gypsum

(Testimony of Stanley H. Barrows.)

($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) falls below the said chemical analysis in gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) content.

(6) In the event that California's cost of production of gypsum for any twelve (12) months' period during the term hereof shall increase five per cent (5%) above its average cost of production of gypsum for the preceding twelve (12) months' period, then and in that event California shall have the right, upon giving sixty (60) days' written notice to Pacific, to increase the price payable hereunder for gypsum thereafter delivered hereunder in an amount not to exceed the actual advance in California's cost of manufacture; provided that in no event may more than one such increase be made in any one calendar year.

California shall keep books of account and records showing its production cost of gypsum, and such books of account and records relating to the production cost of gypsum shall be open to inspection to Pacific at all reasonable times in order to enable Pacific to confirm the correctness of any advance in price permissible under this paragraph.

(7) All new or additional state or federal taxes levied subsequent to the date hereof on the sales covered by this agreement shall be added by California to the sales price and paid to California by Pacific.

(8) This agreement shall bind and inure in favor of the parties hereto, their respective successors and assigns. California is hereby given the express right to assign this agreement to any cor-

(Testimony of Stanley H. Barrows.)

poration of equal financial responsibility with California, or which may operate the plant contemplated to be operated hereunder, with substantially the same properties and plant; otherwise California shall have no right to assign this agreement or any of its rights or obligations hereunder without the written consent of Pacific.

In Witness Whereof, the parties hereto have caused these presents to be executed as of the day and year first hereinabove written.

[Seal] PACIFIC PORTLAND
CEMENT COMPANY,
By /s/ ROBT. B. HENDERSON,
President.

/s/ A. H. CANVIN,
Secretary.
CALIFORNIA CHEMICAL
COMPANY,
By /s/ WILLIAM N. WILLIAMS,
Vice President.

EXHIBIT "A"

Gypsum Analysis and Specification

The gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) purchased under this contract shall conform to the following analysis:

Silica.....	SiO_2	.06
Ferric oxide.....	Fe_2O_3	.06
Aluminum oxide.....	Al_2O_3	.02
Calcium oxide.....	CaO	32.32
Magnesium oxide.....	MgO	.29
Sulphur trioxide.....	SO_3	45.89
Ignition loss. Comb.....	$\text{H}_2\text{O} + \text{CO}_2$	20.70
		<hr/>
		99.34%

(Testimony of Stanley H. Barrows.)

Combined water content=20.40%.

Gypsum content ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) calculated from combined water=97.51%.

Methods of analysis shall conform with the A.S.T.M. "Standard Methods for Testing Gypsum and Gypsum Products" No. C-26-33; except that free moisture shall be determined by drying at room temperature to constant weight.

Free moisture shall not exceed 1%. Water soluble salts other than CaSO_4 shall not exceed 0.4%.

Q. (Mr. Rosenberg): Mr. Barrows, what, if anything, did you have to do with the negotiation of this contract?

A. I had a great deal to do. I believe that I carried on a very large part of the negotiations, all except the last three days, I think it was.

Q. With whom did you carry on those negotiations?

A. Mr. Colton, who then was vice-president, and production manager of Pacific Portland Cement Company.

Q. When did those negotiations commence, approximately?

A. By memory I would say in May, 1936

Q. Can you just trace for us in a general way the course of your conversations with Mr. Colton?

A. To make it as brief as possible——

Mr. Bennett: Just one minute. It seems to me, your Honor, that is going pretty far abroad to permit self-serving declarations, incompetent and irrelevant evidence, and I object to it on that basis.

Mr. Rosenberg: I have asked him to give me conversations, not self-serving declarations. [725]

(Testimony of Stanley H. Barrows.)

Mr. Bennett: That opens the door to start in with their first negotiations and goes through the series of things. Is it your purpose, counsel, by this witness' testimony, to direct this evidence to or in connection with the letter of June 5, 1936, that is in evidence here?

Mr. Rosenberg: I certainly do.

Mr. Bennett: Is that the purpose of this testimony?

Mr. Rosenberg: That is part of the purpose.

Mr. Bennett: What is the other purpose?

Mr. Rosenberg: I think that will develop when we go into it.

Mr. Bennett: I object to it as incompetent, irrelevant, and immaterial.

Mr. Rosenberg: The purpose is obviously this, if the Court please: Mr. Bennett put in a letter, to which I took exception, and I made a motion to strike, and the court denied the motion, which was for the apparent purpose of showing what the intention of the parties was, although the letter was dated seven months before the contract was entered into, and Mr. Bennett also chose for some reason not to fill the gap between the date of that letter and the time of the execution of that contract. As long as that letter has gone in, and perhaps to fill that gap, the purpose of this testimony is to show what actually transpired between the parties.

The Court: Read the question. [726]

Mr. Bennett: The question relates to prior to the letter.

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: Maybe I would like to start a little earlier than you did, Mr. Bennett. That is my privilege.

The Court: Read the question.

(Question read.)

Mr. Rosenberg: These are the negotiations between the parties leading up to the execution of this contract, if the Court please.

The Court: You may answer. The objection may be overruled.

A. Mr. Colton and I had informally discussed the possibilities of a contract between his company and California Chemical Company, contemplating the purchase of gypsum, which we produced—I would say—I would say purchased by his company of gypsum which we produced. After their tests, and they approved the gypsum, Mr. Colton proposed to me that I write a letter roughly outlining the terms under which we would contract for the sale of the gypsum. I did write such a letter.

Q. (By Mr. Rosenberg): I will show you a letter that has been introduced as Plaintiff's Exhibit 5, or which, rather, purports to be a copy of a letter dated June 5, 1936, addressed by you to Pacific Portland Cement Company, attention of Mr. Colton. Is that the letter to which you refer?

A. Yes.

Q. What contract were you speaking of there? What was the subject-matter of which you were speaking? [727]

(Testimony of Stanley H. Barrows.)

Mr. Bennett: Just a moment. I think that ordinarily the documents speaks for itself, and for that reason I would object to this question as incompetent, irrelevant, and immaterial.

Mr. Rosenberg: I will withdraw it, Mr. Bennett. When your Honor admitted this letter I believe you stated you were restricting it to paragraph 11.

The Court: It was admitted only as to the one paragraph of the letter.

Mr. Rosenberg: I really feel, if the Court please, if the letter is going to be admitted, it should be admitted in its entirety, because I believe it shows what the subject-matter of the correspondence was about, which could not be gleaned just from that single paragraph, and if the letter is in, I think that it should be in in its entirety and be considered in its entirety, and I presume Mr. Bennett would have no objection to that.

Mr. Bennett: I take it you are making the request now—I told the court all I was concerned with in the letter particularly was paragraph No. 11, the statement, which the court recalls, stated the contract would contain certain price protection clauses against increases in labor, fuel and supplies. I do not dispute counsel's contention, your Honor, that this paragraph 11 that I was concerned with should, of course, be considered in some relation to the context of the letter, [728] and if he suggests, or proposes that the whole letter be considered in relation to 11, I will not offer any objection to that.

(Testimony of Stanley H. Barrows.)

The Court: Let it be admitted and marked.

Mr. Bennett: It is already in evidence.

The Court: It may go in now in its entirety. It was limited to one paragraph.

The Witness: I had not been permitted, however, to complete my answer to Mr. Rosenberg's question.

Q. (By Mr. Rosenberg): All right.

A. A letter of this sort was a very rough, tentative outline suggesting conditions which would be discussed and added to and perhaps some taken out. It was just an outline of what we could start to negotiate a contract on.

Q. Following this date of June 5, 1936, were there any further discussions between you and Mr. Colton with reference to the subject-matter of the letter?

A. Yes, there were many, many meetings.

Q. Can you tell me the subject-matter of your discussions, what was discussed between you, your best recollection as to the substance of those conversations?

A. There were so many things discussed, you might say every paragraph of the contract was ripped over, back and forth.

Mr. Rosenberg: Mr. Kaapeke, may I have the original of the letter of September 18, 1936?

Mr. Kaapeke: I have copies here. I do not happen to have [729] the original.

Mr. Rosenberg: You have a photostatic copy of it, do you?

(Testimony of Stanley H. Barrows.)

Mr. Kaapeke: I doubt if I have it with me.

Mr. Rosenberg: Will you furnish that to me this afternoon?

Mr. Kaapeke: I think so.

Mr. Rosenberg: With the enclosure?

Mr. Kaapeke: Yes. [729-a]

Q. Mr. Barrows, I show you what purports to be a copy of a letter dated September 18, 1936, to Mr. Colton, and signed California Chemical Company by yourself, attached to which is a form of agreement between Pacific Portland Cement Company and California Chemical Company. I ask you if you recall having written such a letter containing such an enclosure to Mr. Colton.

A. Yes; that is a letter and I would judge that this is a copy of the first rough attempt to put the conditions in contractual form. When you have discussions, those things are submitted, discussed and objections by one or the other, changes put in.

Mr. Rosenberg: I ask that this be marked for identification at this time. I am not offering it in evidence, Your Honor. I would like to compare it with the original that Mr. Kaapeke has offered to furnish.

The Court: Admitted for the purpose of identification.

(The copy of letter dated September 18, 1936, to Mr. Colton from California Chemical Company was thereupon marked Defendant's Exhibit H for identification.)

(Testimony of Stanley H. Barrows.)

Q. (By Mr. Rosenberg): Between June 5, 1936, and September 18, 1936, had there been discussions between you and Mr. Colton with reference to the contract mentioned in your letter of June 5, 1936?

A. I am not able to answer that with positiveness. I have the feeling that when Mr. Colton received my letter he called me up [730] and had some changes to make that I can't recall.

Q. Can you state whether or not following September 18, 1936, and between that date and January 29, 1937, did you have any further discussion or negotiations with Mr. Colton regarding a contract between his company and yours?

A. Very definitely.

Q. During the course of those conversations or discussions, was a contract discussed in the terms and provisions that would be considered in it?

A. Yes. Most of the clauses were discussed including but not limited to, for instance, the tonnage that was involved, the price involved, and we had wanted a cancelation clause which they objected to and finally I guess we acceded to it and the cost of production and future price.

Q. Do you recall the substance of your discussions with Mr. Colton on the subject of the cost of production?

Mr. Bennett: When and where and who was present and what was said? I think he can answer "yes" or "no" first——

The Witness: I can answer those things.

(Testimony of Stanley H. Barrows.)

Mr. Bennett: Wait. If you will just answer that question, you were asked whether you recall the substance, but before you relate the substance——

The Witness: Please repeat the question.

Q. (By Mr. Rosenberg): Did you discuss with Mr. Colton this matter of cost of production of gypsum? [731] A. Yes.

Q. Can you recall when approximately?

A. On several occasions in the fall of 1936.

Q. Can you recall approximately when you had your last conversation with him on that subject?

A. My recollection, it is pretty hard to think back ten years, but my recollection would be in December, 1936, as near as I can recall.

Q. Do you know where you had that conversation?

A. That was in Mr. Colton's office.

Q. In San Francisco?

A. In San Francisco.

Q. Who was present, if anyone, beside you and Mr. Colton?

A. My recollection is just the two of us.

Mr. Bennett: Pardon me. Just a moment. I am sorry to interrupt. What was the date of this conversation?

Mr. Rosenberg: December, 1936.

Mr. Bennett: Can you fix it any more definitely?

Q. (By Mr. Rosenberg): Can you fix it any more definitely than that?

(Testimony of Stanley H. Barrows.)

A. I might by running over—no, I don't think I could. I don't think there is anything in our files that would show it.

Q. Some time in the month of December, is that your best recollection? A. Yes. [732]

Q. Did you state anyone else was present; I believe you stated——

A. No, there were only the two of us.

Q. What was the conversation between you and Mr. Colton on the subject of cost of production?

A. Well, that was a culmination of several previous talks, also the matter of price. When Mr. Colton would not concede to a cancelation clause, I figured that we ought to be pretty careful about being tied up in a price that we couldn't make out on a long-term contract.

Mr. Bennett: I move to strike all the answer, all the witness' answer on the ground it is not responsive and it is a self-serving declaration.

The Court: Do I understand this was a conversation you had at that time and place?

The Witness: A number of conversations, yes; we argued over if we did not have a cancelation clause, why, we didn't want to be stuck with a price that might embarrass us and cost us a lot of money in the future, so I wanted to be pretty careful about what the cost of production would be.

The Court: Proceed.

Mr. Bennett: That shows in his answer that it was not a conversation. He is relating what was in his mind.

(Testimony of Stanley H. Barrows.)

Q. (By Mr. Rosenberg): Did you tell that to Mr. Colton?

Mr. Bennett: That is self-serving. [733]

The Court: I asked him that myself, was this the conversation at that time and place?

The Witness: I couldn't recall the conversation ten years back and say what the words were, but I know that is the subject.

Q. (By Mr. Rosenberg): But you are telling what you told Mr. Colton, are you?

A. I am telling what we were discussing.

Mr. Bennett: I don't want to delay this, but I think the very nature of this shows the propriety of the objection.

The Court: In the interest of time, I will sustain the objection. Reframe the question.

Mr. Bennett: May the last——

The Court: It may go out.

Q. (By Mr. Rosenberg): Mr. Barrows, did you and Mr. Colton have any discussion or conversation regarding the price provisions relating to the sale of gypsum by California Chemical Company to Pacific Portland Cement? A. Yes.

Mr. Bennett: When?

Mr. Rosenberg: Well, you ask him, Mr. Bennett. You take it up. Maybe you can get——

Mr. Bennett: Oh, now, don't be smart.

Q. (By the Court): When did you have that conversation?

A. During the fall of 1936 on several occasions it was discussed. [734]

(Testimony of Stanley H. Barrows.)

Q. During the month of December?

A. It culminated in the month, but it started and went on through October, November and December, because that was a matter we discussed thoroughly.

Q. Tell us as near as you have a recollection of what was said during that period of time in relation to it.

A. The discussions came down to conditions referring to production, cost of production, items of production cost. During this discussion I said, "Well, that is not sufficient, just the items." I said, "I wouldn't be limited to those items, there are other items that go to make up cost of production," and we argued. I mentioned a number of items. He said, "We can't put all these items in." I said, "If we can't do that, then make it the cost of production and we will let the accountant decide what cost of production is." That was the point of the conversation.

Mr. Bennett: May I have that answer read?

(The answer was read by the Reporter.)

Q. (By Mr. Rosenberg): You said to Mr. Colton you would not want to be limited to those particular items. What items do you refer to?

A. Well, I think we put in tentatively at the start—that letter, I believe, of the 25th mentions a few items.

Q. Do you recall the items that you mentioned?

A. No, I couldn't recollect that. [735]

Q. Exhibit 5.

(Testimony of Stanley H. Barrows.)

A. They were not sufficiently clear for a long-term uncancellable contract.

Q. What was Mr. Colton's response to that?

A. I can't relate his response, but it wound up in him saying, "Well, we will just put in cost of production and let it go at that. Cost of production, I presume; I don't know.

Mr. Bennett: I move to strike out the voluntary statement of which we have had so many, which means and so forth——

The Court: What he presumed may go out.

The Witness: If I can amplify that.

The Court: Just a moment.

Q. (By Mr. Rosenberg): Was there anything else there discussed on this subject between you and Mr. Colton?

A. I recall myself suggesting that it be termed cost of production as according to accounting standard practice and I left a note of that before they completed the final contract to Mr. Williams explaining it and that was not put in. Whether I gave him the note or not I don't know, but that was definitely stated.

Q. Between the time that you wrote this letter of September 18, 1936, and January 29, 1937, were there any redrafts of the agreement in the interim?

A. Yes. [736]

Q. Can you state approximately how many there were?

A. I would say two or possibly three.

Q. What would occur when these redrafts would be prepared?

(Testimony of Stanley H. Barrows.)

A. Well, Mr. Colton would scratch, make notes on his copy and I would do the same with mine and we would have a meeting to iron out the items under discussion or approving the items under discussion.

Q. Do you have any recollection of any further conversation with Mr. Colton on the subject of cost of production following December or is the last conversation?

A. I think that was the last one. We agreed at that meeting to put in cost of production.

Mr. Bennett: Now, I move to strike out, "We agreed at that meeting to put in cost of production."

The Court: It may go out.

Mr. Bennett: As involving a conclusion, conjecture.

The Court: It may go out.

Q. (By Mr. Rosenberg): Will you state your best recollection of what was said in that respect?

A. I don't know how to put it in more or less words. We discussed the thing and decided on the terminology, namely, we will have cost of production control that part of the clause that was in our discussion and you come to an agreement when you decide to put something in.

The Court: When you put it in language you come to an [737] agreement, that is a conclusion. You can't spell anything out. Under the law they are entitled to as near as you can relate the con-

(Testimony of Stanley H. Barrows.)

versation had at that time and place, any of it or all of it or what you have a recollection of.

A. Well, I cannot relate that specific conversation ten years back.

The Court: I am not asking you to.

The Witness: I mean, I am answering, I could not tell the words that were used; it is just impossible.

Q. (By Mr. Rosenberg): Can you give us the substance of what was said?

A. I think I have already done that.

Q. Let's do it again. Who suggested the language, cost of production, do you recall?

A. No, I don't. I think we both decided that would cover what we were driving at, the cost of production of gypsum.

Q. In the course of those conversations was it said by either you or Mr. Colton that is the language we will put in the contract? A. Yes.

Q. Did the other party acquiesce and say that would be all right?

Mr. Bennett: This is all leading.

Mr. Rosenberg: Well, you are making a highly technical objection. He is giving a conversation as to what was said [738] after discussing it back and forth, we actually agreed, "Well, we will just put this provision in the contract." Now Mr. Bennett wants him to tell the words that were used.

Mr. Bennett: The witness has said two or three times that he can't recall conversations ten years ago.

(Testimony of Stanley H. Barrows.)

The Witness: Verbatim.

Mr. Bennett: I submit the objection is not highly technical. I further submit this form of question by counsel is leading and suggestive and objectionable particularly in this case.

The Court: Proceed: There is nothing before the Court.

Mr. Rosenberg: That is all.

Mr. Bennett: Are you through, counsel?

Mr. Rosenberg: Yes.

Cross-Examination

By Mr. Bennett:

Q. When did you first have any connection with California Chemical Company, Mr. Barrows?

A. I organized the company.

Q. In 1923? A. Right.

Q. Prior to that time, had you had any interest or connection with a chemical manufacturing concern? A. Not manufacturing, no.

Q. You had been in the chemical industry business?

A. I had been in the magnesite business. [739]

Q. Magnesite business?

A. Yes, mining and producing magnesite.

Q. What concern was that? A. The uses?

Q. No. What company was it?

A. That was the Sierra Magnesite Company.

Q. And you were the organizer and president of California Chemical Company? A. Yes.

Q. You mentioned a plant at Chula Vista and one down at Newark. Did it have any other plant or operation?

(Testimony of Stanley H. Barrows.)

A. This is probably involved, but at the time that this California Chemical Company was in this contract it had taken over the Sierra Magnesite Company and also the National Kellastone Company, a number of other companies, and after the contract consolidated them all in the California Chemical, and then we did have a number of other plants.

Q. You were the principal stockholder?

A. Yes.

Q. In this whole venture of companies?

A. Yes.

Q. In 1937, shortly after this contract in suit here the contract of January 29, 1937, you disposed of all your interests or at least, title to all your interest to the Westvaco Corporation? [740]

A. Yes, we consolidated.

Q. You consolidated them. There was a transfer, according to your understanding, of the physical properties as well as any contractual obligations undertaken by California Chemical Company to the consolidating corporation Westvaco?

A. Correct.

Q. You still have an interest as a stockholder and executive in the defendant corporation, do you not, Mr. Barrows?

A. In Westvaco?

Q. Yes. A. Yes.

Q. As a matter of fact, you are the largest stockholder in Westvaco, are you not?

A. I would rather not answer that.

Mr. Bennett: Well, I think——

(Testimony of Stanley H. Barrows.)

The Witness: I don't think that that is relevant.

Mr. Bennett: I don't want to embarrass you.

The Witness: I have a substantial holding in Westvaco.

The Court: I think that is sufficient for all purposes.

Mr. Bennett: All right, Your Honor.

The Court: The only reason it is admissible at all is any interest he may have in the result of this trial and if he mentions that he has a substantial interest, I think that is sufficient.

Q. (By Mr. Bennett): Westvaco is a large national concern [741] with many plants all over the United States, isn't it? A. Yes.

Q. The term Westvaco was taken from the words West Virginia Company?

A. That's right.

Q. Westvaco has in addition to its New York office, western operation headquarters, taken over this plant which it had formerly had down at Newark; that is correct, isn't it? A. Yes.

Q. In 1931 you were actually producing, in addition to bromine, magnesium products at the plant down at Newark, were you not? A. No.

Q. When was the first time that any magnesium products were produced at the Newark plant?

A. After completion of the plant under discussion, namely, what we termed the Sea Water plant.

Q. You were producing magnesium products during the early 1930's, in 1931 at the Chula Vista plant? A. Yes.

(Testimony of Stanley H. Barrows.)

Q. Was that operation at the Chula Vista plant similar to the later operation at the Newark plant?

A. No, definitely not.

Q. You did not manufacture magnesium from bittern?

A. Yes, but the processes were completely different from the way we produced magnesium down there, it was on a different [742] process than we produced it up here.

Q. Who made the first contract with Pacific Portland or Mr. Colton—Withdraw the question.

You sought and made a proposal to Pacific Portland Cement Company yourself, didn't you, Mr. Barrows, initially?

A. Well, it was pretty informal. We were working——

Q. I am trying to get at, they didn't come to you and seek to buy gypsum, you approached them and proposed to sell gypsum to them.

A. It was made in this light: We are going to build a plant in which we will produce magnesium and gypsum; would you be interested in purchasing the gypsum produced? That is the way it came, and he said, "Well, after we make our tests we will let you know."

Q. The point is, you sought to sell initially rather than Pacific sought to buy this?

A. I would say that was correct.

Q. You also approached the other companies around California and tried to sell them gypsum, too, didn't you?

(Testimony of Stanley H. Barrows.)

A. We approached them in the same way, inquiring whether they would be interested.

Q. What was to be the principal or primary product to be manufactured at this plant at Newark, Mr. Barrows? A. You mean at Newark?

Q. Yes. [743]

A. We figured on the bromine that we were producing as one of the major—I don't think they were considered primary, they were all considered a major product. That is the way we looked at it.

Q. Wasn't it the purpose that you had in mind in building that Newark plant, that it was to be built principally for the purpose of producing magnesium oxide and its related products?

A. This last plant that we are referring to here, it was to produce magnesium and gypsum.

Q. Wasn't the principal and primary purpose of the plant to produce magnesium oxide?

A. Well, I don't think I could answer it in that light. In order to produce magnesium oxide profitably, we have got to produce other things with it. In other words, that was in contemplation for justifying the investment.

The Court: It is time for a recess.

(Recess.) [744]

Q. (By Mr. Bennett): Mr. Barrows, in the manufacture of magnesium oxide it is necessary in an operation involving the basic raw material bittern to remove the sulphate in the bittern water in order to make magnesium oxide, isn't that a fact?

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: To which I object on the ground it is not proper cross-examination. It is beyond the scope of the direct examination.

Mr. Bennett: Counsel on direct examination had the witness relate the very purposes for which these plants were built. I think this is proper cross-examination, bearing upon the very subject, as I understood it, that was the purpose of the direct examination.

The Court: The objection is overruled. He may answer if he knows.

A. I do not think I am competent to answer the processes by which it can be made. It can be made by several processes from bittern. It can be made from sea water. How they get the sulphate out is a matter of the process adopted.

Q. (By Mr. Bennett): You do know from your own experience in this chemical industry that to manufacture magnesium oxide out of bittern water it is necessary to take the sulphate out before you can produce the magnesium oxide, isn't that true?

A. But there are more than one way to get them out.

Q. Yes. Let us assume there are more than one way, but to produce magnesium oxide you have to take the sulphate out, do you? [745]

A. I presume.

Q. Don't you——

A. I couldn't answer that, myself. Our chemical man can.

(Testimony of Stanley H. Barrows.)

Q. They have explained that to you, and they explained it to you long before this contract of January 29, 1937, did they not, Mr. Barrows?

Mr. Rosenberg: Same objection. The man has testified he is not a chemist, your Honor. Mr. Bennett wants to make a chemist out of him.

Mr. Bennett: He was president of the company who signed this contract, and I think I am at least able to test the question of his knowledge of what he was doing, Mr. Rosenberg, as proper cross-examination.

The Court: You may answer.

The Witness: What was the question?

(Question read.)

The Witness: I do not think that that would ever come up with me, as far as I can remember. In a chemical plant there are so many technical operations, they come in and say something to an executive, and explain this and that, and I would not be able to remember.

Mr. Bennett: May I have the deposition of Mr. Stanley Barrows?

Q. Mr. Barrows, I direct your attention to page 10 of the deposition of yours which was taken on October 25, 1947. I will direct [746] your attention to page 9, beginning at line 7, and continuing on page 10, from line 1 to and including line 26.

A. From 7, you say?

Q. Yes, line 7 on page 9, the rest of page 9, and all of page 10.

A. All right, Mr. Bennett.

(Testimony of Stanley H. Barrows.)

Q. Directing your attention specifically to page 10, line 14, I will ask you whether or not these questions were asked and the answers given you at the time your deposition was taken on October 25, 1947.

Mr. Rosenberg: What is the purpose of this? Is this to impeach something?

Mr. Bennett: It is to show the witness at that time knew what this process was and was able to give the answers, Counsel.

The Witness: I do not think so.

Mr. Bennett: I think the court should determine that.

The Witness: The copy speaks for itself.

The Court: He is entitled to a record. We will proceed under the rules.

Q. (By Mr. Bennett): "Q. Now, in the manufacture of these two products from sea water, magnesium and bromine, there results this product in a rough state, as you mentioned, gypsum?

A. Yes.

Q. And unless and until it is refined, that gypsum is [747] the by-product of the manufacture of bromine and magnesium?

A. I would think that was correct."

You gave that testimony at the time the deposition was given?

Mr. Rosenberg: I am going to object to that as being incompetent, irrelevant, and immaterial. It does not have the slightest relations to any of the testimony this witness has given, and this is merely

(Testimony of Stanley H. Barrows.)

an effort by indirection to go into on cross-examination matter that is beyond the scope of the direct examination. This witness has not said anything on the subject of whether or not gypsum is a by-product. How does that tend to refute his testimony?

Mr. Bennett: Your Honor, I think it all has a bearing on the very question we are dealing with here. Your Honor will recall that in the two and a half days that Mr. Flick was under cross-examination a great deal of effort by repeated questions was made as to the character of this product, in an attempt to show that it was not in fact a by-product. Now, the matter of contract, these preliminary negotiations, costs, and so forth, have a direct bearing upon this witness' testimony which he gave on direct examination, and these questions are not only germane but they are preliminary to further examination that I wish to direct the witness' attention to. You will recall that the witness said, "Leave this to the accountants as to what the meaning of cost of production is." I think I am [748] entitled to show on cross-examination, as your Honor indicated should not be narrowed to a narrow scope, what this witness was thinking about in the light of what he alleged he was talking about prior to the time the contract was actually executed.

The Court: I will overrule the objection. Proceed.

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: Then I understand this is asked for the purpose of impeachment, is that right, Mr. Bennett?

Mr. Bennett: This is for the purpose of cross-examining the witness.

Mr. Rosenberg: There are different purposes of cross-examination: one, to elicit evidence, and another to impeach. I submit again, your Honor, this is an attempt by indirection to get into the record questions and answers of this witness which are beyond the scope of the direct examination. If Mr. Bennett wants to ask the same questions now that he asked in the deposition, he is perfectly entitled to do so, and I have my opportunity to object. If the court overrules the objection and the witness answers, and the answer is contrary to the answer he gave in the deposition, then it is perfectly proper to ask him whether he gave a contrary answer in the deposition, but to incorporate in a question, "Were you asked these questions and did you give these answers," which have no relation to the direct testimony, I submit is improper cross-examination. Why doesn't Mr. Bennett ask the witness [749] the same questions that he asked him in the deposition, give me an opportunity to object, and if your Honor overrules my objection, let the witness answer, and if it is not the same as his answer in the deposition, that is the time to read from the deposition.

Mr. Bennett: Your Honor, I think the witness' testimony answers completely all that counsel has

(Testimony of Stanley H. Barrows.)
said. Before I referred to this deposition I asked this witness with reference to the manufacture of magnesium oxide, whether it was necessary to take sulphates out, and he said he did not say anything about it.

The Court: No, he said he assumed they did. The record will so show.

Mr. Bennett: Perhaps I should stand corrected on that point, but an indication the witness did not show——

The Court: However, in the interest of time I will allow him to answer. Read the question.

(The last question was read by the reporter.)

The Court: You may answer.

The Witness: I gave that testimony. However, this process that we develop, intending to develop the gypsum, that is not the only way you can get sulphates out. We did that to make an income from gypsum. That was the purpose of developing that process.

Mr. Bennett: Your Honor, I move to strike that answer [750] of the witness as being volunteer.

The Court: He can explain his answer. Let the question and answer stand.

Q. (By Mr. Bennett): In the manufacture of magnesium oxide in accordance with the plan of operation at the contemplated plant at Newark, to produce that magnesium oxide sometime along the process it would be necessary to remove from the product being processed calcium sulphate that was precipitated in the tanks, would it not, Mr. Barrows?

(Testimony of Stanley H. Barrows.)

A. Yes, I would think so. I would rather have these questions asked of a chemist, but we do take it out. In fact, we made it in order to take it out.

Q. However, in the manufacture of magnesium oxide it is necessary to remove in this process of manufacture calcium sulphate, is that not so?

A. The process was we adopted.

Q. If there was no market for this calcium sulphate it would be simply a waste product or a by-product in the course of manufacture, is that not so?

A. If there were no market for it, that is correct.

Q. Prior to the building of this plant at Newark, you had been producing, in addition to bromine, magnesium products, had you not?

A. Yes, but not at Newark.

Q. Not at Newark? [751]

A. Not at Newark commercially.

Q. Did you know a Dr. Max Y. Seaton?

A. Yes.

Q. In 1931 what, if any, connection did Dr. Max Y. Seaton have with your California Chemical Corporation?

A. Was that a question? I did not get that.

(Question read.)

A. (Continuing): He was vice president and technical director.

Q. I show you Plaintiff's Exhibit 3, which is a photostat taken from this publication of "Chemical and Metallurgical Engineering," of Novem-

(Testimony of Stanley H. Barrows.)

ber, 1931. You have seen this publication and article entitled, "Bromine and Magnesium Compounds, Drawn From Western Bays and Hills," by Max Y. Seaton, California Chemical Corporation, Newark, California, have you not?

A. Yes, I have seen it many years ago.

Q. I direct your attention to the notation that appears on the right-hand portion of the sheet that follows:

"Left: Flow sheet of magnesia products recovery as practiced by the California Chemical Corporation." Then the title, "Below: This lime plant at the Newark works yields an oyster-shell lime of exceptional qualities."

And below that:

"Center: General view of bromine and magnesia products plants at Newark, California."

A. Yes. [752]

Q. Does that refresh your recollection at all as to whether you were producing magnesium products?

A. Sure. That does not refer—that is the pilot plant.

Q. But at the pilot plant you were manufacturing both bromine and magnesia products?

A. No, the bromine plant was a plant by itself. It does not show in this picture. The magnesia products were being produced on a pilot plant basis and not shipped commercially, for those tests to which I have previously referred.

Q. Which is the magnesia plant picture?

(Testimony of Stanley H. Barrows.)

A. This is the magnesia pilot plant.

Q. The picture on the right?

A. That is right—no, that is the lime plant. The magnesia plant does not show here, but there was a small plant of that order in which we produced magnesia.

Q. Dr. Seaton's article states, "Center:—" "referring to this center picture here—" "General view of bromine and magnesia products plant at Newark, California." Look at the center picture and perhaps you can see the magnesia plant there.

A. I do not recognize the magnesia plant. I do not think it shows here. It may give it that term, but I can tell you what that magnesia products plant was. It was for making this pilot plant—it was not used commercially. We shipped nothing commercially until this new plant was built. I am sure plenty of evidence can be produced to confirm that. [753]

Mr. Bennett: I move to strike out the witness' voluntary statement that he feels plenty of evidence can be obtained.

The Court: If it is not a fact, let us find that out.

Mr. Bennett: Yes, I am trying to do that.

Q. (By the Court): There was not any produced commercially? A. Definitely no.

The Court: That is his definite statement.

The Witness: That is right. None, whatever.

Q. (By Mr. Bennett): Which is the bromine plant? A. That is the bromine there.

(Testimony of Stanley H. Barrows.)

Q. You mean on the left center picture is the bromine?

A. And this could be another picture of it. I can't quite place that.

Q. Can you tell me what the right center picture is? A. Is that the right center?

Q. Yes.

A. Let me get on another pair of glasses. These are a little bit weak.

Q. (By the Court): Is this one any better? I have another copy here.

A. That may be the pilot plant.

Q. (By Mr. Bennett): For the magnesia?

A. For the magnesia, yes. It probably is. I know that building there (indicating). We had a very small kiln, and if that is the head gates for getting our lime, and so forth, in [754] there, then it is. That is the magnesia products plant, capable of producing only a few hundred pounds a day.

Q. I am directing your attention to this statement in Dr. Seaton's article, which appears on page 640 of the magazine:

"Exit liquor from the bromine recovery towers has essentially the same composition as the raw bittern with the exception that its small bromine content has been replaced with chlorine. Some 3 per cent dilution by condensed steam also has occurred. Both Newark and Chula Vista plants process this liquor for magnesium chloride recovery. This step involves the concentration of the bittern in multiple-effect, salt-type vacuum evapo-

(Testimony of Stanley H. Barrows.)

rators. Sodium chloride separate hot, while cooling of the evaporated liquor (in batch coolers at Chula Vista; continuous coolers at Newark) gives an essentially pure, saturated solution of magnesium chloride, which is separated from magnesium sulphate, potash, and residual sodium salts by settling and centrifuging. The magnesium chloride solution is further evaporated in open pans until it has the composition——”

A. You see, there is a process of getting the sulphates out without making gypsum.

Q. Continuing my quotation: “— $\text{MgCl}_2 \cdot 6\text{H}_2\text{O}$, and this hot liquid is chilled to give solid, flake or powdered commercial magnesium chloride.”

A. Right.

Q. What was done with the magnesium products that were produced at the Newark plant from 1931 on, Mr. Barrows?

A. They were all used for various test purposes. We were doing a lot of work making special refractory brick in the East, and we made special types of magnesia and set out the batches for them to try out.

I can say your impression is incorrect. There was no magnesium products made at Newark commercially before this Major Sea Water Plant.

Q. I am not deriving impressions as evidence.

A. I just wanted to get it clear.

Q. I am reading from what Dr. Seaton has said: I direct your attention again to this following state-

(Testimony of Stanley H. Barrows.)

ment on page 640 under the title of "Other Salts Now Recovered."

"The present magnesium chloride market which can logically be served from a Pacific Coast plant will absorb but a fraction of the total magnesium values present in the bittern now being received, which quantity is regularly increasing as salt consumption of the West Coast steadily grows. Accordingly, after extensive laboratory investigation and some two years' pilot operation, a small plant for recovery of these values in other forms is now in production and a large plant is being engineered. Basically, the method employed is that of conversion [756] of soluble magnesium values to magnesium hydrate through reaction with lime, and further processing of this magnesium hydrate. The scheme can claim no novelty in conception, as it has been repeatedly suggested for the treatment of Stassfurt residues and for Michigan and Ohio River brines."

At that time, back in 1931, you were contemplating and had done engineering work for the building of this larger plant, had you not, Mr. Barrows?

A. Seaton says so. I think it was very preliminary work, though.

Q. Do you dispute what Dr. Seaton said, that "a large plant is being engineered"?

A. Yes, I would dispute that.

Q. In other words, that statement by him was untrue?

A. I think that was for publication, that they were working in a general way.

(Testimony of Stanley H. Barrows.)

Q. In other words, you contend that in that statement Dr. Seaton was misrepresenting the facts?

A. He was painting a rosy picture, I guess.

Q. He was your chief executive down there at the time, was he?

A. Yes, at Newark, but not for the company.

Q. Did you ever tell him that he had made mis-statements in this article?

A. I don't think so. I don't know that I ever picked up that reference. Our men may have been doing some engineering in a very preliminary way.

Q. Now, I also call your attention to this further statement by Dr. Seaton on page 640 of the article, Plaintiff's Exhibit 3: "The byproduct gypsum from the process through operation of favorable location factors, is marketable at a profit instead of being a valueless waste."

Do you agree with that statement by Dr. Seaton?

A. Well, I think that needs amplification. It is a valueless waste as it comes out but you have to put in a lot of equipment and put in processes to manufacture it into useful gypsum.

Q. You have to dry it and grind it?

A. You have to treat it with acid, you have to wash it, you have to dry it, you have to grind it, a number of factors that make it useful for commercial gypsum.

Q. In any event, in 1931 and in 1937 and 1938 after this new plant was in operation in the manufacture of the magnesium products, there was of

(Testimony of Stanley H. Barrows.)

necessity a removal of calcium sulphate necessary to the manufacture of the magnesium products; isn't that correct?

A. Yes, because we chose that process.

Q. That was the same process that was being followed back in [758] 1931 when Dr. Seaton wrote this article?

A. That was the pilot plant that led up to this process.

Q. So in 1931, six years before this contract was entered into, the same thing occurred down at the pilot plant that later occurred with this plant in the process of manufacturing magnesium oxide, you had this calcium sulphate which, unless it was further processed, was simply a waste.

A. That's right, nothing, but we did process it and use it for test purposes.

Q. Back in 1931 when the article was written, what was the favorable location factor that made these waste products marketable?

The Witness: Is that of any value to the thing we are trying to get at here?

Mr. Bennett: I think the Court will decide and determine that.

The Witness: Well, those——

Mr. Rosenberg: I submit, Mr. Bennett, it is improper to cross-examine this witness on what somebody else wrote 16 years ago.

The Court: As I said, that goes to the weight of the testimony. I may indicate that for the pur-

(Testimony of Stanley H. Barrows.)

pose of the record at this time so that nobody is misled on the subject.

The Witness: Shall I answer?

The Court: Read the question. [759]

(Question read.)

The Witness: Shall I answer?

The Court: Yes.

A. To the best of my knowledge, having selected this plant which is going to use lime for eliminating the sulphates, we were located on San Francisco Bay, close to very large deposits of pure lime which could be purchased at a low cost; we built a canal to bring it up to the plant so it would be moved at a very low cost, and the bitterns also concentrated at the same point at a low cost through pipe lines from the salt plant, the market for gypsum was immediately favorable because the freight rate to move gypsum from Newark to the Redwood City plant was 50 cents a ton whereas in the rest of the gypsum coming into this territory, carried \$3.50 or \$4.00 a ton freight without the cost of the gypsum. It made a combination of favorable factors, that is what made us decide to produce gypsum.

Q. (By Mr. Bennett): In other words, the location of the plant made it possible to market this gypsum? A. Yes.

Q. At a profit instead of being a valueless waste?

A. Certainly.

Q. The only cement plant at Redwood City is the plant of the plaintiff Pacific Portland Cement Company, isn't it? A. Correct. [760]

(Testimony of Stanley H. Barrows.)

Q. Do you know how much relative tonnage of magnesium oxide is produced in relation to the amount of this byproduct gypsum?

A. I wouldn't like to have my figures go into the record because I am not sure enough of them, but if I might approximate, I would think perhaps 40 to 50 thousand tons of gypsum would be produced and probably a like quantity of magnesium.

Q. What is the value of magnesium oxide per ton, Mr. Barrows?

Mr. Rosenberg: If the Court please—

Mr. Bennett: I will withdraw the question.

Q. In 1937, January 29, 1937, as well as during the year 1936, what was the value or market price of magnesium oxide?

Mr. Rosenberg: I object. This is obviously not cross-examination.

Mr. Bennett: It is preliminary to show this plant down there was built primarily for the purpose of magnesium oxide. They built the plant and it produced what was simply a byproduct, as the contract states. It all has a bearing upon the discussion, or the testimony that this witness gave on direct examination. It is preliminary and I am coming specifically to these conversations that the witness had with Mr. Colton.

Mr. Rosenberg: I submit, if the Court please, I put this witness on the stand to testify to certain subjects and I think his cross-examination should be confined to that. I have only one thing in mind,

(Testimony of Stanley H. Barrows.)

frankly, I know Mr. Barrows has not [761] been in good health and he is supposed to go home in the afternoon and rest. I was hoping his cross-examination should be completed by the time we adjourn at noon.

The Court: There is no reason why we cannot conclude with the witness. I will sustain the objection. With that thought in mind let us proceed.

Q. (By Mr. Bennett): When you wrote this letter of June 5, 1936, to Mr. Colton, you proposed that you sell the gypsum delivered, loaded on cars for \$2.60 a ton, didn't you?

A. I think the record will show what it was. Whatever——

Q. The letter said that.

A. Whatever is there is what we agreed to.

Q. You said here in this letter, paragraph 5:

“We would offer to sell you all of the gypsum produced by said plant except 3,000 tons for which we reserve the privilege of marketing for chemical uses. This would leave an estimated 15,000 tons per year of gypsum which we would offer you at \$2.60 per ton, loaded on cars at our plant at Newark.”

A. Yes, but I think we later discussed that——

Mr. Rosenberg: Just a minute. There is no question. What are you asking him?

Mr. Bennett: Preliminarily I am asking if that was the price.

A. That was in the preliminary— I think that was changed in the final draft, if I recall. [762]

(Testimony of Stanley H. Barrows.)

Q. Yes, that was the first quoted price.

A. That is my recollection.

Q. Then you stated here in paragraph 11 of this letter:

“Contract would contain certain price protection clauses to guard against increases in labor, fuel and supplies.”

At that time, Mr. Barrows, all you were concerned with was that in this 30-year contract which later became a 20-year contract, that you would be protected against increases only in labor, fuel and supplies?

A. Yes, but that contemplated we would have a cancelation right so if it ever got out of hand, we would cancel; that is why we got into this cost discussion later, for better protection.

Q. But at that time the thing you were thinking about in so far as a price protection clause, was increases in labor, fuel and supplies involved in the manufacture of this gypsum?

A. With the protection of cancelation.

Q. Let us leave aside the cancelation.

The Court: You can't very well.

The Witness: You can't.

The Court: If counsel wants to have him say——

Mr. Bennett: He is stating it but I am asking him about the particular costs. Remember, Your Honor, during the direct examination of this witness he was permitted to discuss at great length the various costs that he had discussed with Mr.

(Testimony of Stanley H. Barrows.)

Colton. [763] I think I am entitled, or should be entitled, according to my understanding, to discuss the changes, if any.

The Court: I have indicated previously I have allowed the widest latitude and I purpose to do it again. Here is a witness called, he was an executive, he acted in this contract; it follows that within reasonable limits cross-examination should be confined to his direct examination. We have gone into this article and a number of other matters that had no relation to his testimony. However, in the interest of time you can ask him.

Mr. Bennett: Maybe I have been very remiss in not having properly explained to Your Honor the exact purpose I had. I certainly would not have gone into it unless there was some purpose in doing it. I think Your Honor will at least credit me with that amount of intelligence, but maybe I did not make myself clear to Your Honor. The examination of the witness on cross-examination——

The Court: I would like to make it clear to you and counsel on the other side, we have consumed twice as much time as you asked for in this case. I have allowed the widest latitude so that nobody would be offended because he did not have an opportunity to be heard. I think I tried to indicate that before. I repeat it again. With that thought in mind, proceed.

Q. (By Mr. Bennett): Aside from this cancellation feature which [764] you say you had in

(Testimony of Stanley H. Barrows.)

mind, the only cost, the particular items of cost that you were concerned with at that time were the items of labor, fuel and supplies; is that correct?

Mr. Rosenberg: At the time when he wrote the letter?

Mr. Bennett: Yes.

Mr. Rosenberg: I will so stipulate.

Mr. Bennett: All right.

Mr. Rosenberg: The letter is the best evidence.

Mr. Bennett: I am cross-examining. Remember counsel's cross-examination of Mr. Flick, it took two long days over a wide field of subject matter.

The Court: Well, you consumed most of that time yourself.

Mr. Bennett: I have not consumed two days yet. I have just had this witness.

Mr. Rosenberg: You had him on direct for four days.

The Court: You can't compare this witness with other witnesses. However, I don't want to discuss these matters. Proceed. He so stipulated. Proceed.

Q. (By Mr. Bennett): On September 18, when you sent this draft of agreement to Mr. Colton, you were still concerned only with price advances in labor, transportation, fuel or supplies, weren't you?

A. If that contains a cancelation clause that was the protection there against incomplete listing of the items of increased cost. [765]

(Testimony of Stanley H. Barrows.)

Q. Will you please point out to me where the cancelation is as proposed by you in this September 18 agreement?

Mr. Rosenberg: Let me do that. I think I can do that quicker than the witness, if you do not object.

Paragraph 12: "It is further understood and agreed that California shall have the right to cancel this agreement at any time upon giving written notice to Pacific of its intention so to do, by delivering such written notice to said Pacific at least one year prior to the date of cancelation."

Q. (By Mr. Bennett): I address your attention to paragraph 6, Mr. Barrows.

Mr. Rosenberg: That is not in evidence.

Mr. Bennett: Well, it is marked for identification. Do you want to put it in evidence?

Mr. Rosenberg: No. I want to see the original.

Mr. Bennett: Well, I have no objection to it going in evidence.

Mr. Rosenberg: No. I prefer to have it go in evidence in correct form.

Mr. Bennett: All right.

Q. This draft that you proposed and submitted to Mr. Colton stating, "The prices hereinabove stipulated to be paid by Pacific for gypsum, quick lime and hydrated lime, are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation [766] of the contemplated new plant proposed to be erected at Canal Head, Newark, Cali-

(Testimony of Stanley H. Barrows.)

fornia, and it is therefore understood and agreed in the event of price advances and labor, transportation, fuel or supplies resulting in an increase of 5 per cent or more in cost above the first year's average direct cost hereinabove referred to, f.o.b. car shipping point, then and in that event California shall have the right to increase the price to Pacific to the extent of the increase of the said average direct production cost for lime or gypsum."

Now, did you write that language or was that language written by your attorney?

A. That was written by my attorney. I did not follow you very well, it was pretty involved.

Q. Well, you read this paragraph 6 when your deposition was taken last October, didn't you?

A. I don't remember. I mean, I am not trying to evade, but I just don't—

Q. So this language was the language used by your attorney?

A. In the first rough draft, yes.

Q. You state here that, "The prices hereinabove stipulated to be paid by Pacific for gypsum," which was—

A. \$2.60.

Q. \$2.80 per ton was based upon the average direct cost to California to produce the material covered by this agreement. What did you mean—

Mr. Rosenberg: Read it. Don't stop in the middle of the sentence. "—average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected"—

(Testimony of Stanley H. Barrows.)

Mr. Bennett: I have read it once. I will read it again if you want.

Mr. Rosenberg: I don't care as long as the witness knows what is in there.

The Witness: Well, why put in so much time on this when this was not the contract. The contract represents the discussions between Colton and myself, what we arrived at.

Q. (By Mr. Bennett): Now, I would like to know how you determined this average direct cost to produce the material in order to determine this contract price of \$2.80.

A. Don't ask me. I suppose our accountants would determine it. You mean that \$2.80?

Q. Yes.

A. I would think our man Seaton had figured the gypsum could be produced for that and that included some reasonable profit. That is a short-cut.

Q. When you submitted this draft to Mr. Colton, it was your understanding—by the way, "price hereinabove stipulated * * * are based upon the average direct cost to California to produce" gypsum?

A. Yes, because we couldn't get—if the prices got out of hand, [768] got out of line, we would cancel the contract. That is what I understood.

Q. The point is now, the direct cost as you understood it and you referred to in this paragraph 6.

A. I am not an accountant. My understanding of direct costs would be labor, fuel and supplies and supplies are pretty broad.

(Testimony of Stanley H. Barrows.)

Q. Would you say, though, generally it took the costs that were necessary—— A. Yes.

Q. ——to the process by drying, grinding or any other thing that was necessary to the calcium sulphate after its separation from the main raw material?

A. I would rather not get involved in a technical discussion.

Q. You submitted this draft to Mr. Colton; I want to get what your understanding was of direct costs.

A. Direct costs were for labor, fuel and supplies.

Q. It was upon that basis of your direct costs that this contract, proposed contract price of \$2.80 a ton was based; is that it?

A. Right. The direct costs at that time.

Q. You offered to sell the gypsum at that price. That was your proposal of the price, \$2.80, subject to all these other conditions? A. Yes.

Q. You said, Mr. Barrows, that during the conversation with [769] Mr. Colton later on, that there was some discussion about what costs should go in and what costs should not be considered.

The Court: Is there any hope of getting through with this witness this morning?

Mr. Bennett: I think it will take perhaps five or ten minutes at the most, but I hate in a matter of this importance to forego—I do not feel I am doing justice to my client.

(Testimony of Stanley H. Barrows.)

The Court: I don't think you need to apologize to anyone for your presentation of this case, much less the Court.

(Discussion off the record as to the next appearance of this witness and a recess taken until 2:00 o'clock this afternoon.) [770]

Tuesday, December 23, 1947, 2:00 o'Clock P.M.

FRED MELHASE

called as a witness on behalf of the defendants, being first duly sworn, testified as follows:

Direct Examination

By Mr. Rosenberg:

Q. Where do you live, Mr. Melhase?

A. Newark, California.

Q. What is your profession?

A. A chemist.

Q. By whom are you employed?

A. The Westvaco Chlorine Products Corporation.

Q. How long have you been in the employ of that corporation?

A. Since 1933. At that time it was known as the California Chemical Company.

Q. Have you been continuously in the employ of the California Chemical Company and its successor Westvaco Chlorine Products Company ever since 1933?

A. That is correct.

Q. Will you just give us a brief statement of your education and experience as a chemist?

(Testimony of Fred Melhase.)

A. I graduated from the University of California in 1932 with a B.S. degree in chemistry. I went to work for Westvaco in 1933. I believe it was in September of 1933. I have been employed there ever since. [771]

Q. In what capacity were you originally employed? What were your duties?

A. I originally went to work for the California Chemical Company as an operator in a pilot plant which was being built at that time. Actually I worked as a laborer in the plant, the pilot plant, while it was being built.

Q. Then after the plant was built, what were your duties?

A. I was an operator in the plant for about a year.

Q. What do you mean by an operator, Mr. Melhase?

A. Well, one who controls the operation of the process—in other words, turns the valves and so on in a chemical plant.

Q. Will you explain what that pilot plant that you speak of was? What processes were taking place in that plant?

A. That was a plant that was built primarily to investigate the technical phases of a process for producing gypsum and magnesia and also to determine the economic value of those products.

Q. How long did you continue as an operator in the pilot plant?

A. About a year, I believe.

(Testimony of Fred Melhase.)

Q. Then what duties did you take up?

A. At that time I went into the research department as a research chemist.

Q. How long did you continue in that employment?

A. From about 1934 to 1943, as I recall.

Q. What were your functions and duties in the research laboratory? [772]

A. My functions were to work, help work out the technical phases of the pilot plant operation.

Q. And then after the new plant was constructed in 1937, did you perform the same services in relation to the operation of the new plant?

A. Largely so.

Q. And then you say you continued in the research laboratory until 1943, did you say?

A. I believe so, yes.

Q. What has your position with the company been and your duties since that date?

A. Since that date I have been in charge of the process control department and the control laboratory.

Q. Will you explain what the functions of the process control department and the process control laboratory are?

A. The function of the control laboratory is to analyze raw materials, intermediate and finished products, so that proper judgment can be exercised in controlling the operation of the plant and also the quality of the finished products.

(Testimony of Fred Melhase.)

Q. Does that cover generally the scope of the process control department?

A. The process control department observes the operation of the plant on a day-to-day basis in order to improve the efficiency, improve or at least keep up the quality of our finished products, and if possible, to lower costs of production. [773]

Q. Let me ask you, is the gypsum that is produced at the Newark plant tested and analyzed in the laboratory? It is.

Q. Which laboratory is that?

A. The control laboratory.

Q. Will you explain in a general way, Mr. Melhase, the processes at the Newark plant of the Westvaco Chlorine Products Corporation, starting with the time that the raw bittern comes into the plant and follow it in its course throughout the plant, and in connection there with also, will you advise us as to what this bittern is in fact, what is the chemical composition of it, and then trace its course through the plant in a general way?

A. This bittern, as we call it, is a product that was originally a waste, I believe, from a salt company around Newark. It is composed largely of magnesium sulphate, magnesium chloride, sodium chloride, potassium chloride, bromine and practically all the minor elements that are present in sea water.

As we receive the bittern from the Leslie Salt Company, it is stored in large earthen storage ponds, which hold about a year's supply of bittern.

(Testimony of Fred Melhase.)

From these storage ponds it is transferred as needed into three small concrete feed ponds. As it is introduced into those feed ponds, it is acidified with sulphuric acid. From the feed ponds the bittern is pumped to the bromine plant and is there stripped of its bromine content by chlorine and steam. As the bittern leaves the bromine plant, it [774] contains more acid than the original feed bittern, and therefore must be neutralized partially with lime before it can be used further.

After leaving the bromine plant, it is pumped to the gypsum plant or the gypsum department, and in case the bromine towers are not operating the bittern is pumped directly from these concrete feed ponds to the gypsum department. At the gypsum department it is mixed with what we call calcium chloride bittern, which precipitates the sulphates as gypsum and produces what we call the magnesium chloride bittern. After this magnesium chloride——

Mr. Bennett: May I interrupt for a moment? I hate to delay things but I did not quite have this last answer clear and it would aid me.

The Court: Read the answer.

(Record read.)

The Witness: After the magnesium chloride is separated from the gypsum in large settler tanks, a portion of it is wasted and the remainder is transferred to the magnesia department, where it is treated with lime, which precipitates the magnesium hydroxide and forms what we call a calcium chlor-

(Testimony of Fred Melhase.)

ide bittern. All of this calcium chloride bittern, or as much as we can recover, is returned to the gypsum department and it is used there to precipitate more sulphates, more gypsum from the incoming debrominated bittern or acidified raw bittern. [775]

Q. What is the chemical symbol for gypsum?

A. $\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$.

Q. There has been some mention here in the testimony of magnesium oxide. Will you explain what that is and where that comes out, if at all, in the plant at Newark?

A. Magnesium Oxide—the chemical term for it is MgO —and it is produced from the magnesium hydroxide, which is precipitated with lime and there after purified.

Q. What are the products or what is the product that comes out of the magnesium plant? What do you call that? A. Magnesia.

Q. Getting back to this magnesium chloride, I believe you stated that after the gypsum has been taken out in the gypsum department, you have what you call the magnesium chloride bittern.

A. That is correct.

Q. And that in turn goes to the magnesia department?

A. Not all of it. Part of it is wasted.

Q. But the part that goes to the magnesia department, is that the material from which the magnesia is extracted? A. That is right.

Q. You say that a part of it is wasted. Will you explain what you mean by that?

(Testimony of Fred Melhase.)

A. I merely mean that we discard roughly half, a little less than half of that magnesium chloride, that is produced when the [776] gypsum is precipitated. That probably goes back into the Bay. We just dump it out.

Q. What is the reason for that?

A. We do not need all the magnesium chloride bittern.

Q. Do you extract from the bittern the maximum quantity of gypsum that may be produced therefrom?

A. Yes, we do.

Q. Do you extract or recover from the bittern the maximum amount of magnesium that may be recovered therefrom?

A. No.

Q. Is the amount of gypsum that you recover dependent upon the amount of magnesium that you produce?

A. Not completely so, no.

Q. Will you explain what you mean by that?

A. Could I have that question again?

(Question read.)

A. Well, to produce some of this magnesium, it is necessary to remove the sulphates from the bittern, but in our operation we not only remove that portion of the sulphates but also the sulphates from all the bittern that enters the plant.

Q. (Mr. Rosenberg): And then that leaves you, does it, with the magnesia chloride bittern?

A. That is right.

Q. And I believe you stated that you do not utilize all of the magnesia chloride bittern that results from the gypsum [777] operation because you

(Testimony of Fred Melhase.)

have no need to recover that quantity of magnesium, is that right? A. That is correct.

Q. What did you say is done with it?

A. Part of it is wasted.

Q. What is that?

The Court: Half of it is utilized and the other half goes into the Bay.

Q. (Mr. Rosenberg): Does the Westvaco Chlorine Products Company operate a plant at Chula Vista, California? A. It does.

Q. What is the nature of that operation there?

Mr. Bennett: Now, wait a minute. What is the purpose of that, counsel?

Mr. Rosenberg: This is preliminary.

Mr. Bennett: I know when I said the same thing——

Mr. Rosenberg: All right. I will state the purpose. I want to show that although in your discourse you have taken the position that this is something that is produced off the primary product, I want to show that at Chula Vista, California, we operate a chemical plant where magnesia chloride is the end product and there is no further processing from that point on; so that it is not true, as Mr. Bennett said, that this is something that is produced for the primary product and incidental to the recovery of magnesium oxide. At Chula Vista, California, [778] we operate a plant for the express purpose of producing magnesium chloride and we do not follow through and make magnesium out of it.

(Testimony of Fred Melhase.)

Mr. Bennett: Your Honor, I think that explanation shows the utter irrelevancy of his testimony.

The Court: For that limited purpose I will allow it. Proceed.

Q. (Mr. Rosenberg): Does Westvaco operate a chemical plant at Chula Vista, California?

A. Yes.

Q. Will you explain what process is there?

A. The process there is to recover magnesium chloride from the bitters that are produced at Chula Vista.

Q. Is that the end of the process at Chula Vista? A. It is.

Q. So I understand you do not further process the magnesium chloride and recover magnesium from it?

A. No, it is sold there as liquid magnesium chloride or as flake magnesium chloride.

Q. Do you produce any gypsum in the course of your operation at the Chula Vista plant?

A. We do not.

Q. Do you get the sulphate out of the bitttern?

A. We take the sulphate out as magnesium sulphate during the evaporation of the bitttern. [779]

Q. And that removes the sulphate from the bitttern, does it? A. It does.

Q. Will you explain what the purpose is of adding sulphuric acid to the bitttern?

A. When the bromine towers are operating, the purpose of the sulphuric acid is to increase the chlorine efficiency in the bromine plant to inhibit the chlorine from hydraulizing.

(Testimony of Fred Melhase.)

Q. (The Court): I do not follow that. Will you explain that answer?

A. I will go over it again. The purpose of the sulphuric acid, the addition of sulphuric acid to the bittern, when the bromine plant is operating, is to improve the chlorine efficiency. Chlorine is more expensive than sulphuric acid. Does that explain it?

The Court: Proceed.

Q. (Mr. Rosenberg): And is it necessary to the recovery of bromine that you add the sulphuric acid to the bittern?

A. It is necessary to the extent that we want to improve the chlorine efficiency.

Q. What function, if any, does the sulphuric acid play in the production of gypsum?

A. The function of the sulphuric acid in the production of gypsum is to decrease the amount of organic material that is precipitated with the gypsum and to alter the shape and the size of the gypsum crystals which facilitate its further [780] purification and washing, drying, and so forth.

Q. When the bromine department at the Newark plant is not operating, is it necessary, in your opinion as a chemist, to use sulphuric acid for the purpose of producing gypsum? A. Yes.

Q. Will you state whether or not in your opinion you could produce magnesium oxide without introducing sulphuric acid into the bittern?

A. Yes, magnesium oxide could be produced without the use of sulphuric acid.

(Testimony of Fred Melhase.)

Q. Do you know whether you have conducted any experiment or any test at the Newark plant for the purpose of determining whether or not you can produce specification gypsum without using sulphuric acid in the bittern?

A. Yes, we have. In order to verify our previous conclusions regarding the necessity of using sulphuric acid for the production of gypsum, we conducted a test—I believe it was in October of this year—in which we deliberately left out the sulphuric acid in order to see whether the gypsum could be produced economically under such conditions. We found that it was not economical to do so because as a result of leaving out the sulphuric acid our filter cloth blinded very rapidly.

Q. (The Court): You mean by that what?

A. Plugged up.

Q. (Mr. Rosenberg): Have you finished your answer, Mr. [781] Melhase?

A. I do not believe so.

The Court: Read the answer as far as he had gone.

(Record read.)

The Witness: As a result of this blinding, the filter picked up an uneven cake, which threw a veritable load on our drying and made the drying of the gypsum very difficult.

Q. (Mr. Rosenberg): Mr. Melhase, I will show you Defendant's Exhibit G, which is the contract between Pacific Portland Cement Company and California Chemical Company, and direct your at-

(Testimony of Fred Melhase.)

tention to Exhibit A thereof, which is titled, "Gypsum Analysis and Specification." Are you familiar with the gypsum specifications provided in that exhibit and as a part of that contract?

A. Yes, I am.

Q. Will you state whether or not——

The Court: Pardon me. Raise your voice, Mr. Melhase, so you can be heard.

Q. (Mr. Rosenberg): Will you state whether or not under those specifications it is necessary in the production of gypsum to comply with those specifications that the amount of magnesium in the gypsum is limited to a certain amount or a certain percentage?

A. Yes, it is necessary to limit the amount of magnesium oxide in the gypsum to a certain quantity. [782]

Q. And what is specified?

A. .29 of a per cent.

Mr. Bennett: Isn't that all covered by the contract?

Mr. Rosenberg: I do not know, Mr. Bennett.

The Court: You expect me to construe the contract. I need all the information I can get, particularly when we get in the chemical field; I will confess my limitation on that score.

Mr. Bennett: Very well, Your Honor. If Your Honor wishes to hear that.

The Court: You may have had the enjoyment of going through this chemical field some time or other, but on the journey I missed that.

(Testimony of Fred Melhase.)

Mr. Bennett: Your Honor still knows more about it than I do.

The Court: Proceed, counsel.

Q. (Mr. Rosenberg): Will you state whether or not, Mr. Melhase, in order to make gypsum that will meet the specifications provided in that contract, it is necessary to remove the magnesium from the bittern?

A. It is necessary to separate the magnesium chloride from the gypsum that is produced, yes.

Q. Would you as a chemist consider that the sulphate in the bittern is an impurity?

A. I would not consider the sulphate in the bittern as an [783] impurity as such. It is merely one of the constituents of the bittern.

Q. Would you consider the gypsum in its raw state and before it has been ground and filtered and dried as a valueless waste?

A. No, I would not consider it as a valueless waste. It could be stored out in the open some place in a stock pile and later on someone could come along and process that gypsum and make a salable product out of it.

Q. Mr. Melhase, I show you an article that states it is from the Pacific Chemical and Metallurgical Industries, issued October, 1938, entitled "Bromine, Lime, Magnesium, Gypsum; a running description and pictorial record of their production from bittern in shell by Pacific Chlorine Products Corporation at Newark, California," and directing your attention to the section which is designated, "Gyp-

(Testimony of Fred Melhase.)

sum," and specifically the pictures opposite that page, I ask you if you can identify those pictures and tell me what they portray.

Mr. Bennett: Just a moment, Your Honor. Again I am confronted with the problem of not wishing to have the Court precluded from having all light on this subject, but at the same time I am confronted with the necessity of perhaps objecting to evidence as not in the proper form. This matter of photographs, their use and introduction in evidence, as Your Honor knows, for several reasons is limited by certain requirements. I understand counsel's purpose is to get before the Court a [784] pictorial view of what they content is a so-called gypsum plant or that portion of the plant down at Newark where certain processes involved in this case are carried on, but I have never seen it. There is no way I can check it, and there is a question whether those pictures are taken to scale and accurately represent the situation, and for that reason I am going to object to them on the ground that they are incompetent, irrelevant and immaterial and not the best evidence.

Q. (The Court): What is this magazine article and these photographs?

A. Those are pictures of our magnesia or the gypsum portion of our plant. I do not know that they all are. I recognize some of them.

The Court: What is the purpose of them?

Mr. Rosenberg: The point was it might be helpful to the Court to see what the gypsum plant consists of, if Your Honor please.

(Testimony of Fred Melhase.)

The Court: If I am in doubt about the plant or have any difficulty on that score, I will take a trip down to Newark.

Mr. Bennett: I wanted to take a trip down there but we could not agree, Your Honor.

The Court: I may go down myself with the consent of both sides.

Mr. Bennett: I would welcome that.

The Court: However, unless I change my view, there will be no necessity of going down there. Proceed, gentlemen. [785]

Mr. Bennett: What happened to the picture that you have just shown——

Mr. Rosenberg: I have it.

Mr. Bennett: I think we ought to have it marked for identification. After all, you have shown it to the court.

Mr. Rosenberg: But I have not offered it. Yes, I am sorry.

Mr. Bennett: After all, you have shown it to the court.

The Court: Let it be admitted and marked.

Mr. Bennett: It was over my objection.

Mr. Rosenberg: I did not show it over your objection. You say I showed it to the court.

Mr. Bennett: I thought you did.

Mr. Rosenberg: Well, you are wrong again.

Mr. Bennett: I withdraw the words "you showed it to the court." You handed it up.

The Court: The court helped himself to it.

(Testimony of Fred Melhase.)

(The photograph was marked Defendant's Exhibit I for Identification.)

Q. Mr. Rosenberg: Mr. Melhase, will you explain as briefly as you can to the court the methods employed at the Newark plant in sampling and testing the gypsum that is produced there?

A. We control the quality of our gypsum by means of shift samples. The shift——

The Court: You control what? [786]

A. The quality, we control the quality of our gypsum by shift samples. These shift samples consist of a number of grab samples that are taken by the operator at regular intervals during the shift. We place these in containers which at the end of a shift are taken to the laboratory and the samples thoroughly mixed, and then analyzed for ignition loss, chloride, alkalinity. At the end of the day the shift composites are made up into a daily composite, which are saved until the end of the week; then the daily composites are made up into a weekly composite on a weighted average base. A portion of the weekly composite, I believe, is submitted to the Pacific Portland Cement Company for their analysis.

Q. In your opinion as a chemist, does that method of separating and testing in that way offer a fair criterion of the general quality of the output of the gypsum department?

A. I think that it does, yes.

Q. When you are operating at Newark but not

(Testimony of Fred Melhase.)

producing bromine, what happens to the bromine contained in the bittern?

A. It is wasted, it goes back into the bay, along with the exit bittern.

Q. Just one further question. In these chemical processes here is it necessary to produce gypsum in order to produce magnesium chloride?

A. No, it is not necessary to produce gypsum.

Mr. Rosenberg: That is all. [787]

Cross-Examination

Q. (Mr. Bennett): Is it necessary to remove the calcium sulphate—I will withdraw that. Is it necessary to remove the sulphates from the calcium sulphate in order to produce gypsum?

A. In order to produce gypsum?

Q. Not gypsum, but magnesium chloride.

A. The bittern which we have is composed of both calcium sulphate and magnesium chloride, that bittern which is used, a portion of the bittern which is used for the production of magnesia, the sulphates must be removed from—

The Court: You will have to talk louder than that. You can talk louder than that when you are at the plant, can't you?

Q. (Mr. Bennett): You have been here during this whole trial, haven't you?

A. I have been here during a good portion of it, not all of it.

Q. You have been here during the time that both myself and Mr. Rosenberg, your company's

(Testimony of Fred Melhase.)

counsel, were discussing this chart, Plaintiff's Exhibit 16, For Identification?

A. I believe so, yes.

Q. In the bittern water as it comes to you, or as you have it in your storage tanks, there is a chemical substance known as magnesium sulphate; is that correct?

A. You can assume that it is magnesium sulphate. It is present there as magnesium ions and sulphate ions. [788]

Q. Yes. To manufacture magnesium oxide you have to remove the sulphates or separate the sulphates away from the magnesium, do you not?

A. Yes, and a portion of the bittern which is used for the production of magnesium, the sulphates must be removed.

Q. Let's forget for a minute we are making any gypsum or calcium sulphate, that we are just making magnesium oxide. In accordance with the practice that you follow at Newark, magnesium oxide is the primary product for which that plant was designed, wasn't it?

Mr. Rosenberg: I object to that as not proper cross-examination.

Mr. Bennett: This whole examination has been pointed up, as I understand it, that they built a plant there to produce mainly gypsum, that is the inference I get from the story. I want to show that was not the case. The inference is sought to be drawn that gypsum is not what the contract states,

(Testimony of Fred Melhase.)

a by-product. Otherwise, I don't know what the witness has been offered for.

The Court: I will allow the question. Overruled.

(The question was read by the reporter.)

A. (The Witness): No, I would say it was not. The product for which this plant was designed and built, the plant was designed and built for both products, gypsum and magnesium oxide. [789]

Q. (Mr. Bennett): Well, the primary or principal product was magnesium oxide, wasn't it?

A. I would consider them all as products.

Q. I asked you which was the main or primary product to be produced, magnesium oxide or gypsum?

Mr. Rosenberg: I object on the ground it is not intelligible. You tell the witness upon what standard he has to testify to determine whether or not something is primary or principal.

Mr. Bennett: Well, counsel, the witness must know perfectly well, which is the primary product.

The Court: If he knows he may answer.

The Witness: I think it will depend on a point of view, if you are considering it only as a magnesium oxide plant then that would be your main product, but I don't think that is the case here. I think the plant was built to produce both, and also bromine. You might call one or the other a secondary product, depending upon the economic value.

Q. (Mr. Bennett): The economic value of the total amount of magnesium oxide produced in any

(Testimony of Fred Melhase.)

one year is at least many times greater than the total value of the gypsum produced there, isn't it?

A. I don't know. That is something that the management has to do with.

Q. Do you know the total that is produced of magnesium oxide in [790] relation to——

A. They are roughly the same.

Q. Let us consider them roughly the same. You do know the magnesium oxide is a much more valuable product, don't you, according to its market price?

A. According to its market price it may be, but according to net return to the company it may not be.

Q. Well, you are talking now about net return, is that what you mean? A. Yes.

Q. Again forget about making any gypsum down there, but using the same process that you follow in the actual manufacture of this magnesium product, it is necessary to get the sulphates out of the magnesium in order to get magnesium oxide; isn't it?

A. You take the sulphates out of the bittern, too.

Q. That is an essential step in the manufacture of magnesium oxide, isn't it?

A. It is essential in this process, yes.

Q. You can't make magnesium oxide without taking away the sulphates from it, can you?

A. No. You can not make gypsum without taking the magnesium chloride away from it.

(Testimony of Fred Melhase.)

Mr. Bennett: I move to strike out the last part of the witness' answer. [791]

The Court: It may go out.

Q. (Mr. Bennett): When you get down into your final step of making the magnesium oxide if there was any sulphate contained in that product that sulphate would then be an impurity, wouldn't it?

A. That is correct. However, in the process of producing that magnesium oxide from the magnesium hydroxide the sulphates would probably be driven off in the process.

Q. Yes. You can't make magnesium oxide without first driving off the sulphates?

A. What I mean there by that answer is the sulphates, in order to make magnesium oxide out of magnesium hydroxide, it is necessary to calcine that magnesium hydroxide at a very high temperature. In that process of calcination the sulphates are driven off.

Q. Yes. That driving off of the sulphates, is at least one of the steps necessary to make magnesium oxide, isn't it?

A. The final magnesium oxide cannot contain very much sulphate—

Q. If it does contain sulphate the sulphate is considered an impurity from a chemical point of view, isn't it, in magnesium oxide?

A. That is correct.

Q. The very purpose, at least, of taking out the sulphates from the magnesia in the bittern water is

(Testimony of Fred Melhase.)

to remove the impurity from [792] the end product of magnesium oxide, isn't it?

A. I wouldn't say it was to remove an impurity from the magnesium oxide. It is to take it out before the magnesium hydroxide is precipitated.

Q. Yes; in other words, to remove from the bittern water an impurity which otherwise would contaminate the whole product magnesium oxide?

A. I wouldn't call the sulphates an impurity in the bittern. They are more or less a constituent of the bittern.

Q. As long as it is joined together in a chemical compound the magnesium sulphates, or the sulphate is an impurity or it would be an impurity in making magnesium oxide; isn't that correct?

A. In the bittern, itself, the sulphates is not combined with the magnesium. They are both a number of ions.

Q. To separate this sulphate, however, from the bittern water so you have in the bittern water magnesium without the contamination of sulphate, you use calcium chloride, do you not, to effect a precipitation of the sulphates? A. Yes.

Q. That step is absolutely essential to purify the magnesium free from any sulphates in one of the steps to make magnesium oxide?

A. It is necessary in order to precipitate the magnesium without co-precipitating the sulphate.

Q. Now, Mr. Melhase, it is a fact, isn't it, that when this bittern water is added to calcium chloride

(Testimony of Fred Melhase.)

that causes the precipitation in your precipitating tanks? A. That is correct.

Q. This matter that precipitates out in the form of crystals or solid matter in the mixing tank is calcium sulphate, isn't it?

A. It is gypsum.

Q. Well, isn't it calcium sulphate?

A. It is $\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$, which is gypsum.

Q. Is it calcium sulphate with 2 molecules of water? A. That is correct.

Q. That is the precipitated matter that occurs in your vats after the addition of the calcium chloride to remove or separate the sulphates out of the bittern? A. Yes.

Q. When you are not running this fluid to the bromine towers the very first step is to cause that precipitation of the sulphates in the bittern, isn't it? A. Correct.

Q. The reason of that is so you can separate the sulphates away from the bittern water?

A. That is correct.

Q. Unless you do that you can't continue the process and manufacture the end product, magnesium oxide, can you? [794]

A. It could be done in another manner by causing magnesium sulphate to precipitate.

Q. Well, it wouldn't be as feasible or economical as the method you pursue down at your Newark plant, would it? A. It would not.

Q. Now, again assuming this calcium sulphate, or, as you call it, gypsum, is dumped out and not

(Testimony of Fred Melhase.)

used at all, the next step—I will go back. Strike that question.

To remove the calcium sulphate, or the gypsum, you have in these large tanks in your assembly line or your plant line, you have a filtering process, do you not?

A. After most of the separation occurs, yes.

Q. And this calcium sulphate or the gypsum in these crystals or floating forms adhere to this so-called filter cloth of your filter, that is the way it is taken out of the bittern?

A. That is correct.

Q. After it is taken out of the bittern you have left in the bittern magnesium chloride, don't you?

A. I might go back and say that in that separation most of that separation of the gypsum from the magnesium chloride occurs in Dorr thickener tanks under which flow the concentrated solids from those tanks that you filter.

Q. That is one of the steps along the line of the manufacture of magnesium oxide?

A. What step is that? [795]

Q. The step you have just mentioned, the tank, you call that where the solids are filtered out?

A. It might be considered as such.

Q. Well. isn't it such?

A. The gypsum is separated from the magnesium chloride in that step, yes.

Q. Whether you use the gypsum or throw it out, it is separated at that step; that is correct, isn't it?

A. That's right.

(Testimony of Fred Melhase.)

Q. Then this bittern water goes on to the next step of processing in which after the calcium sulphate or the gypsum is filtered out you have left in the bittern, at least, magnesium chloride in solution?

A. That is correct.

Q. To get magnesium hydroxide, which is one of the steps, the next step in the process, you have to use calcium hydroxide, don't you?

A. It does not have to be limited to calcium hydroxide.

Q. Well, don't you add calcium hydroxide in your operation?

A. We don't add calcium hydroxide. We use quicklime or dolomite.

Q. That is the equivalent of that calcium hydroxide, isn't it?

A. I would consider it, yes, as far as precipitation of other magnesia.

Q. You have used other forms of calcium hydroxide, have you?

A. No.

Q. You have used dolomite?

A. And quicklime. [796]

Q. The purpose of adding that in your next step in the manufacture of magnesium oxide is to separate the magnesium from the chloride, isn't it?

A. It is to precipitate the magnesium as a magnesium hydroxide.

Q. In other words, the magnesium, after the addition of the dolomite or the equivalent of calcium hydroxide combines with hydroxide to form magnesium hydroxide, doesn't it?

(Testimony of Fred Melhase.)

A. We add lime or dolomite to this magnesium chloride combination which precipitates magnesium hydroxide and forms a calcium chloride bittern.

Q. In other words, it forms this new combination of magnesium hydroxide? A. Right.

Q. That is formed in a nature of precipitation, isn't it? A. Correct.

Q. It is from that magnesium hydroxide that you manufacture the magnesium chloride, isn't it?

A. After it has been separated from the calcium chloride, washed and purified, then it is conducted by heat into magnesium oxide.

Q. This residual of calcium chloride that is left in the bittern water is taken out and used again in the process as before, isn't it?

A. Yes, that calcium chloride that is separated from the magnesium hydroxide goes back to the gypsum department and is reacted [797] there with an acidified raw bittern to precipitate gypsum.

Q. Please consider we are not making any gypsum at all. We are making, according to your process down there, magnesium oxide. If that gypsum is saved or manufactured into usable gypsum this whole process that you have described here would all be a process in the magnesium plant, wouldn't it?

Mr. Rosenberg: Well, your Honor——

Mr. Bennett: The point is, they apparently have put emphasis on the fact that it goes to the gypsum plant. I want to show, your Honor, that is a misnomer, saying it goes to the gypsum plant. The

(Testimony of Fred Melhase.)

witness has already described now a process of manufacture where he has admitted to manufacturing magnesium oxide, your Honor, and they take this gypsum out of the product. What I want to show, your Honor, is the witness' testimony about the interjection of the word "gypsum" is misleading and a misnomer.

The Court: Tell me, are you familiar with the chart? A. I have looked it over, yes.

Q. Having in mind your familiarity with the plant, now, go down to that chart and indicate to me in your own way the beginning of the bittern and going to magnesium sulphate and trace that bittern through the various operations here for me. Do you understand my question?

A. I think that I do. I think you want me to describe the process that I outlined previously in my testimony. [798]

Q. Yes.

A. Using the chart.

Q. Yes. It may help me.

Mr. Bennett: No, I have no objection to that, your Honor. All I want is to clear up the fact that this gypsum had to be removed from the bittern in order to make magnesium oxide.

Mr. Rosenberg: Of course, the gypsum is not in the bittern.

Mr. Bennett: Well, it is partly in the bittern, part of it is added; that which is added is added to effect removing the sulphate from the bittern in order to make magnesium oxide, just as you have

(Testimony of Fred Melhase.)

to take the pit from a peach in order to can the peaches, if you can sliced peaches.

The Court: For the moment, don't pay any attention to these attorneys in their arguments. In other words, from that chart trace the various steps.

The Witness: The bittern, as we receive it from the Leslie Salt Company, it contains both magnesium chloride and magnesium sulphate.

The Court: Just a minute. Now, start again.

A. The first step in the process is to take out the bromine. The second step is to remove the sulphates from the bittern. You understand that the magnesium and chlorides and sulphates are all present as ions in the bittern. There is no chemical combination that can be assumed to be magnesium sulphates and magnesium chlorides and so on. The next step after the [799] bromine is removed is to take out the sulphates from the bittern. There we take out the maximum quantity of sulphates; because gypsum is one of our products, we want to get as much of it as we can.

Mr. Bennett: Does your Honor want to leave that in there; otherwise I move to strike out the argument.

The Court: That part may go out. Proceed.

The Witness: The sulphates are taken out of this bittern by means of calcium chloride, which precipitates these sulphates as gypsum. Then it leaves in solution magnesium ions and chloride ions, which we call magnesium chloride, and part of

(Testimony of Fred Melhase.)

that magnesium chloride bittern is then thrown away because we have no use for it. The remainder of it goes to the magnesium department, and is treated with lime or dolomite, that is here (indicating), and that forms a precipitation to magnesium hydroxide, which also results in the formation of what we call calcium chloride, the bittern which is brought back and added to the incoming raw bittern to precipitate sulphates from it. Does that help?

The Court: Yes; let us proceed.

Q. (Mr. Bennett): In this process at what time is the sulphuric acid added to the bittern?

A. As I stated before, the sulphuric acid is added when the bittern is pumped from the large storage ponds into the concrete feed ponds.

Q. That is before there is any attempt made by the addition [800] of calcium chloride to extract the sulphates?

A. It is prior to that and also prior to any attempt to extract bromines.

Q. When you are not manufacturing bromine products this bittern does not go to the bromine towers at all, does it? A. No.

Q. It goes into the line of these pipes, and tanks, and pumps and the filter?

A. It is pumped directly from the feed pond to the gypsum department.

Q. What do you define as the gypsum department, Mr. Melhase?

A. Well, all the precipitating tanks, the settling tanks, the pumps, filter, washing and drying equipment and the warehouse, so on.

(Testimony of Fred Melhase.)

Q. Leaving out any equipment that is used to dry or grind or deliver the gypsum after it is precipitated and filtered out of the bittern, what do you call the gypsum plant?

A. After it is filtered out of——

Q. Leaving aside, forgetting such facilities as you have over there for drying and grinding and delivering the gypsum after it is filtered out, what do you consider, what do you include in this statement “Gypsum plant”?

A. Well, I would consider the precipitating tanks, the Dorr thickener tanks, the pumps that pump it up to the filter, as all part of the gypsum plant. [801]

Q. If you are not grinding or drying gypsum, if you are pumping this calcium sulphate or the gypsum that is filtered out into the bay all of these pumps and tanks, filter and all, would be necessary, would they not, according to your system of manufacturing magnesium oxide for the manufacture of that particular product, magnesium oxide, wouldn't it?

A. Precipitating tanks would be necessary.

Q. In fact, all the things you say that constitute the gypsum plant, except the facilities for drying and grinding and delivering the gypsum would all be essential in the manufacture of the magnesium oxide, wouldn't they? A. Yes.

Q. So in that sense this bittern goes, when it does not come over to the bromine tank, bromine towers, to the first step of the magnesium plant?

(Testimony of Fred Melhase.)

A. I would say it goes to the gypsum plant.

The Court: What do you mean by that?

A. I consider the next step in our operation as the gypsum plant or the gypsum department that I just outlined; the precipitation tanks from a chemist's point of view, would be a part of that department.

Mr. Bennett: You recall, do you not, I believe for the first two weeks in September, 1946, when you pumped all this gypsum out into the bay and did not save any of it or dry any of it or deliver any of it—— [802]

A. No, I don't recall that we did that. To my knowledge, the first time that we ever pumped gypsum out into the flat or waste pile is when it has been necessary to shut down some of the drying equipment or filtration equipment, for repairs.

Q. In other words, when any of this drying or grinding equipment that is used to treat this calcium sulphate or the gypsum that is filtered out of the bittern would not permit processing of this gypsum by drying and grinding you then pump it out into the bay, is that right?

A. No, we don't pump it into the bay. It is pumped into a flat where it is stored.

Q. You heard Mr. Flick's testimony where Mr. Williams told him that during, or Mr. Wallace told him that during the first two weeks in September, 1946, they were pumping this slurry out into the bay?

Mr. Rosenberg: I don't think he said that. If I understood Mr. Flick, Mr. Wallace told him they

(Testimony of Fred Melhase.)

were going to do that. I don't think he ever testified that Williams told him they were doing that.

Mr. Bennett: He testified Mr. Williams said they were at that time pumping this slurry actually.

The Court: Well, were you there during the period?

The Witness: Yes, I was there.

The Court: What was the fact? [803]

The Witness: To my knowledge none of the gypsum was pumped out into the bay or even into the flat at that time.

Q. (Mr. Bennett): Even when you pumped it up into the flat this process goes right on as far as the pumping of the bittern from the storage tank into the settling tank and the filtering tank and so forth, in the process of manufacturing the end product, magnesium oxide; is that not a fact?

A. When anything happens to that drying or filtering, drying or grinding equipment and it becomes necessary to pump it out into the flat, that is done in order to keep from shutting the entire plant down.

Q. Yes.

A. Which would be a very expensive process. As a matter of fact, that washing, drying, and grinding equipment would only be down for a short period of time.

The Court: We will take a recess.

(Recess.) [804]

Q. (Mr. Bennett): You mentioned your plant at Chula Vista. Is bittern the basic raw material

(Testimony of Fred Melhase.)

from which you manufacture magnesium chloride at that plant? A. It is.

Q. The same type of operation?

A. The same type of operation.

Q. You do not have any bromine towers down there?

A. We have bromine towers there, yes.

Q. The first step is to pump the bittern into the bromine towers after you have added sulphuric acid?

A. When the bromine towers are operating, yes, that is correct.

Q. So when this bittern comes in from your storage ponds, you add the sulphuric acid and then it goes into the bromine towers, is that right? The bittern goes on to the bromine towers?

A. Will you read that question?

(Question read.)

A. That is right.

Q. What happens both at Chula Vista and also at the plant at Newark, is that correct?

A. That is right.

Q. The purpose of this sulphuric acid is to reduce the alkalinity of the bittern water?

A. It is to neutralize that alkalinity and make the bittern slightly acid.

Q. When the bromine towers are operating, the sulphuric acid [805] remains in the solution, does it not, after the bromine is extracted?

A. Yes, it is still there.

Q. Ever since you started operation down at

(Testimony of Fred Melhase.)

Newark of this new plant, you have used sulphuric acid continuously, have you?

A. I believe so. As far as I know, it has been used all the time.

Q. Are you the one down at the plant who has charge of the actual operation or is that in charge of some other individual?

A. That comes under the plant superintendent.

Q. Mr. Wallace?

A. No, the direct operation comes under Mr. Bradley, who is the plant superintendent.

Q. As far as you know, this sulphuric acid has been used in the initial steps of this processing from the time this enlarged plant started operation in 1937?

A. It has been used ever since I have been at the plant, since 1933.

Q. That is what I was coming to. You have always used the sulphuric acid both in the earlier operation prior to the building of this large plant, and since then?

A. Yes. It was used primarily to increase the chlorine efficiency in the bromine towers.

Q. You spoke about a test that you made this past October. Why did you make that test, Mr. Melhase? [806]

A. As I said before, to make certain that our previous conclusions regarding the function of the sulphuric acid were correct.

Q. Was that the first test that you had made concerning that?

(Testimony of Fred Melhase.)

A. I believe that it was, yes.

Q. And that test was for the purpose of this lawsuit, wasn't it? A. Not necessarily.

Q. It was long after this lawsuit was brought?

The Court: His answer was, "Not necessarily." The question and answer may stand.

Q. (Mr. Bennett): Had you made any previous laboratory or other test to determine the effect of sulphuric acid in the manufacture of magnesium oxide or gypsum?

A. We had not made any test as such, but in our operations, when the bromine plants are operating we add lime to that exit bittern from the bromine plant to partially neutralize it, because we found that too much acid in that bittern is harmful, too, from the standpoint of precipitating the sulphate and on occasions we have added too much lime to the bittern and it made it alkaline. And we have also run into difficulty with our gypsum operation under such circumstances. This test was merely to verify the previous indications that we had in that regard.

Q. When you had bittern that was alkaline that caused you [807] trouble in your precipitation, just what trouble was that? Do you mean it made more difficult the precipitation of the gypsum out of the bittern water?

A. It made subsequent filtration, washing and drying of that gypsum difficult.

Q. It also made difficult the removal of the gypsum from the bittern water, didn't it?

(Testimony of Fred Melhase.)

A. No. I would say no.

Q. It made difficult the filtration of the gypsum out of the bittern, didn't it?

A. Yes, it made filtration difficult but it did not affect the precipitation.

Q. Filtration of the gypsum is an essential step in making the magnesium oxide, isn't it?

A. No, it is not.

Q. You have to filter the gypsum or remove the gypsum out of the bittern to manufacture the magnesium oxide, don't you?

A. The gypsum, as I stated before, is settled out of the bittern in this Dorr thickener tank and we waste a good portion of the magnesium chloride bittern, so it is not necessary to filter that gypsum unless we are going ahead and make specification gypsum out of it.

Q. How are you going to get the gypsum out of the bittern water so that you can go on making the magnesium oxide if you do not filter it? [808]

A. We allow it to settle in the Dorr thickener tanks and pump it out of those tanks as a slurry.

Q. What do you mean by a slurry?

A. A heavy suspension of solids in the bittern.

Q. Without filtration you still have traces, is not considerable substance, of the gypsum in the bittern solution, don't you?

A. No, most of the bittern, the magnesium chloride bittern that we use in the magnesia process does not go through a filter at all. It is merely decanted off the top of one of these tanks.

(Testimony of Fred Melhase.)

Q. Oh, you mean these magnesium chloride that you continue on into the next step, adding dolomite or lime or this calcium hydroxide, is pumped off before the filtering operation to secure the gypsum occurs?

A. It is decanted off the gypsum slurry prior to the filtration of that slurry.

Q. (The Court): Slurry—I do not quite follow that.

A. Slurry is a heavy concentration of solids in a liquid, in this case bittern.

Q. As sediment?

A. Sediment, settled solids.

Mr. Bennett: I do not know that I have that quite clear and I do not know that the Court has, either.

Q. Can you describe in a little more detail that phase of the [809] operation of those tanks that you speak of?

A. All right. After the raw bittern, the acidified raw bittern or debrominated bittern is brought back there in what we call pachuca tanks, which are reaction tanks, after raw bittern or debrominated bittern is brought together in those tanks with calcium chloride, it forms a light slurry or suspension of gypsum in this magnesium chloride bittern.

Q. Yes?

A. That slurry is run out into Dorr thickener tanks or settling tanks. The overflow from those tanks is magnesium chloride bittern, a portion of which is wasted and a portion of which goes to the

(Testimony of Fred Melhase.)

magnesia plant for the precipitation of magnesium hydroxide. The underflow from those tanks contains a small portion of the bittern, which is taken out by a filter if the gypsum is processed.

Q. What is done to the bittern that is taken out of the filter?

A. Right now it is being thrown away because we do not need that bittern, as I stated before. We need only about half of the magnesium chloride bittern that we produce.

Q. What did you do with it before? You say right now. What did you do with it at a previous time?

A. At one time, when we were producing the maximum quantity of magnesia that it was possible to produce from these bitters, it was saved.

Q. It was saved for further processing by the addition of [810] dolomite or lime or calcium hydroxide, is that right?

A. That is quite right.

Q. For the processing of magnesium oxide?

A. But now we do not require all that bittern for the magnesium oxide plant and it is thrown away.

Q. When were you last producing this so-called maximum amount when you used all this bittern after the gypsum was taken out for the manufacture of magnesium oxide?

A. Oh, that was prior to 1943 some time, I believe, when our bittern supply was quite low.

Q. As a matter of fact, during the war period up to 1945, you were still endeavoring to produce

(Testimony of Fred Melhase.)

the maximum amount of magnesium oxide that your plant was capable of making, weren't you?

A. That is correct.

Q. So you were not throwing away any of these magnesium chloride during that period of time, were you?

A. Yes, we were still throwing away magnesium chloride because there were other limitations to our plant, other than the amount of magnesium chloride that was available.

Q. Do you have any production records down there or would you know about that, showing month by month or weekly operations as to the amount of bittern that is purchased and used and the amount of chemicals that are purchased and used and the operation reports of this process?

A. I presume that there are such reports. We use all the [811] bittern that is available to us for the precipitation of gypsum. All of the bittern that we receive from the salt company is used for that purpose.

Q. You said that before. I am asking you about these operational reports. You do not keep such reports, do you?

A. I do not keep such reports, no.

Q. Who would keep those reports?

A. If anyone has them, I imagine it would be the plant superintendent, the records of the amount of magnesium chloride thrown away.

Q. Would Mr. Watt have such records?

A. I do not know.

(Testimony of Fred Melhase.)

Q. You heard the statement of counsel for your company that prior to 1946 no part of the sulphuric acid was charged against gypsum production, didn't you?

Mr. Rosenberg: That is not what I said, Mr. Bennett. It was some time in 1945 when the bromine towers were shut down.

Mr. Bennett: Yes. I stand corrected as to the date.

Q. (The Court): Do you know anything about that?

A. Could I have that question over again?

(Question read.)

A. I do not know whether that remark has been made before or not. I guess it has.

Q. (Mr. Bennett): Did you know that that was the fact?

A. I do not know how the records have been kept, so far as the [812] charges are concerned.

Q. Assuming it was a fact, do you know why there was no charge for sulphuric acid made against gypsum up until that time?

Mr. Rosenberg: If the Court please, I put this man on as a chemist and not as an accountant, and I submit that that is not proper cross-examination and it is beyond the scope of the direct examination. He is going into accounting now.

The Court: The objection is sustained.

Mr. Bennett: I did not intend that. I do not want to take time arguing, but this witness has testified to other things than chemistry. He has

(Testimony of Fred Melhase.)

outlined the detail there and he has testified on direct examination as to why the sulphuric acid was necessary in gypsum.

The Court: The Court has ruled.

Mr. Bennett: Thank you, Your Honor.

Q. The addition of sulphuric acid to bittern water has always been used by the company from the very start of your connection with it back in the early 30's, hasn't it? A. Yes.

Q. Where the bittern in solution is alkaline, it does affect the precipitation and crystallization of the gypsum or calcium sulphate in the bittern solution, does it not?

A. It would not affect the actual precipitation. It would affect the shape and size of the crystals, which would in turn affect its filtration, washing and drying. [813]

Q. I direct your attention to your company's answer to the 20th interrogatory proposed by the plaintiff, in which the following appears:

"Answer: Interrogatory 20. Defendant states that sulphuric acid was necessary in the production of gypsum because the pH of bittern is too high to permit the proper precipitation of gypsum from the bittern and this sulphuric acid is added to the bittern to lower the pH to a point where the separation of the gypsum from the bittern is possible."

Do you agree with that statement?

A. I do not agree with it the way it is stated. They mean there that sulphuric acid is necessary to precipitate the gypsum in a form in which it can

(Testimony of Fred Melhase.)

be handled later on in this filtering, washing and drying operation.

Q. You did not prepare or having anything to do, then, with preparing this answer to plaintiff's interrogatory 20 that I have just read?

A. I do not believe so.

Q. I read further from the answer to the interrogatory:

“A large portion of the sulphuric acid added is incorporated in gypsum produced because the sulphate ions in the sulphuric acid precipitate with the calcium ions in the bittern to produce gypsum aggregating approximately one-half of 1 per cent of the total gypsum produced. In other words, sulphuric acid serves a double function: one, of controlling the [814] basicity of the solution and, two, of actually adding weight for weight to the gypsum produced.”

Do you agree with that statement?

A. I agree to the fact that this sulphuric acid which is added to the bittern would be precipitated along with the sulphates. It would be precipitated along with the rest of the sulphates that are in the bittern, correct.

Q. Do you agree with the statement that by the addition of sulphuric acid it actually increases the production of gypsum approximately one-half of 1 per cent of the total gypsum produced?

A. I do not know what that figure would come out to be, but it would increase the quantity of gypsum that can be produced.

(Testimony of Fred Melhase.)

Q. Do you also agree that adding it to the bittern produces weight for weight to the gypsum produced? In other words, adding a pound of sulphuric acid actually produces an additional pound of gypsum?

A. It would actually produce more than a pound of gypsum.

Q. Then this statement in the defendant's answer to the interrogatory is not correct, according to your understanding?

Mr. Rosenberg: That is argumentative.

Mr. Bennett: I think it is proper cross-examination, Your Honor. Here they blow hot on the one hand and now they put on a witness who blows cold on the other. I think this is eminently proper cross-examination. [815]

The Court: Read the question.

(Question read.)

The Court: It is argumentative, but I will let him answer in the interest of time.

A. The molecular weight of sulphuric acid is around 96 or 98. Gypsum has a molecular weight of 172, I believe. So the relationship between the weight of sulphuric acid and the weight of gypsum would be 172 to 98. In other words, 172 pounds of gypsum for every 98 pounds of sulphuric acid.

Q. (Mr. Bennett): What is the value or cost of a pound of sulphuric acid, Mr. Melhase?

A. I think it is around \$18 a ton.

Q. And that would be about how much a pound? How many cents a pound?

(Testimony of Fred Melhase.)

Mr. Rosenberg: How much did you say, Mr. Bennett?

Mr. Bennett: He said \$18 a ton.

A. (The Witness): 9/10 of a cent. I think that figures out to 9/10 of a cent per pound.

Q. (Mr. Bennett): 9/10 of a cent?

A. I think so.

Q. The cost of sulphuric acid per pound, then, would be approximately 9/10 of a cent per pound, wouldn't it?

A. I think that is correct.

Mr. Bennett: On that basis, counsel, assuming the price that you have demanded currently for this gypsum, \$4.36 a ton, [816] that would approximate about 2/10 of a cent per pound of the value of gypsum that you place upon there; that is a fact, too, isn't it?

Mr. Rosenberg: That I place upon it?

Mr. Bennett: Well, your client asks \$4.36 a ton for gypsum, and that figures out to 2/10 of a cent per pound, doesn't it?

Mr. Rosenberg: I do not know. If you have figured it out, subject to check, I will accept it.

Q. (Mr. Bennett): Assuming you get two pounds of gypsum for every pound of sulphuric acid added, that still does not result in a profitable operation to the company, does it, Mr. Melhase?

Mr. Rosenberg: I submit that that is argumentative and it is completely unintelligible. It has no foundation in fact. We are not selling sulphuric acid; we are selling gypsum.

(Testimony of Fred Melhase.)

Mr. Bennett: I know, but you see the purpose for adding this is that it adds weight for weight to the gypsum produced.

Mr. Rosenberg: It says it serves two functions. If you want to argue with me, I will argue it out with you, but I do not think it is proper to argue with the witness. He did not say that. I prepared those answers and I confess there may be some inaccuracies in the chemical answers.

Mr. Bennett: You put this witness on to show the necessity of adding sulphuric acid for the production of gypsum. It is an important point in the case and I think I am entitled [817] to cross-examine on it.

Mr. Rosenberg: I have no objection to your cross-examining.

Mr. Bennett: And I am certainly entitled to cross-examine in relation to these interrogatories you filed in this case.

Q. What do you understand as controlling the basicity of the solution, Mr. Melhase?

A. Controlling the pH of the solution or the hydrogen ion content of that solution.

Q. In other words, to raise the acid character of the bittern from what otherwise would be an alkaline stage, is that correct?

A. That is correct, to make the bittern more acid.

Q. And the reason for that increase of acidity is to further the precipitation of the gypsum?

(Testimony of Fred Melhase.)

A. The purpose of it is to precipitate the gypsum in a form which can be handled later on.

Q. I want you to first admit that it does further the precipitation, in whatever form, of gypsum, does it?

A. I do not know what you mean by further the precipitation.

Q. I read to you, and I will read again, this answer of the defendant to our 20th interrogatory:

“The defendant states that sulphuric acid was necessary in the production of gypsum because the pH of bittern is too high to permit the proper precipitation of gypsum from the bittern, and this sulphuric acid is added to the bittern to lower the [818] pH to a point where the separation of the gypsum from the bittern is possible.”

Now, do you still agree or disagree with that statement?

A. I think from a chemical standpoint I would disagree with that statement, yes.

Q. You do not know on what source of authority your company made that statement?

A. No, I do not. [819]

Q. In 1943 you substituted dolomite as an agent to add to magnesium chloride in the bittern water after the sulphate or gypsum had been taken out in place of some other chemical product, didn't you?

A. That is correct; we substituted in 1943 dolomite for quicklime in that operation.

Q. Why was the dolomite substituted for quicklime?

(Testimony of Fred Melhase.)

A. In order to increase the capacity of the magnesia plant beyond the point of precipitation and to increase the capacity of our counter-current washing system.

Q. In other words, to produce more magnesium oxide, wasn't that it?

A. That was one of the things.

Q. When you used dolomite to any given quantity of bittern water you produced more magnesium oxide than that if you used lime. don't you?

A. That all depends on how much dolomite you use.

Q. If you used the amount of dolomite necessary to produce the magnesium hydroxide that from which magnesium oxide is produced you get a higher quantity in pounds of magnesium oxide than if you had used lime for that purpose, don't you?

A. In treating this bittern with lime or dolomite, as the case may, if you used dolomite in place of lime pound for pound more magnesium is produced.

Q. Yes. In other words, when you started to use dolomite it [820] was for the purpose of increasing the total production of magnesium oxide; isn't that correct?

A. Yes. Our plant facilities there were not such that we could produce enough lime in our plant to produce all the magnesium that we required.

Q. You also gave us another reason.

A. Also, our settling tanks were not large enough when lime was used. Magnesium hydroxide

(Testimony of Fred Melhase.)

precipitated from the dolomite has better settling and washing characteristics and filtration characteristics than a product from quicklime.

Q. And it also has a greater quantity pound for pound in relation to the end product to the amount of bittern used than would be the case of using lime? A. That's right.

The Court: What effect has this on the other products?

The Witness: What other products are you referring to?

The Court: You say it increases the volume of magnesium more than the others, this dolomite.

A. I don't believe it has any.

Mr. Rosenberg: That is added after the gypsum is taken.

The Court: I understand. I was trying to trace it. In any event he said it had none. What was the answer?

The Witness: It had no effect on the volume of gypsum.

Q. (Mr. Bennett): According to Plaintiff's Exhibit 18, which contains figures furnished by the defendant, Mr. Melhase, it appears that in the calendar year 1942, when you were using [821] lime down here where this word calcium hydroxide appears in the chart you produced 31,826 tons of gypsum, and in the next calendar year, 1943, when you used dolomite, the gypsum production went to 24,431 tons; that drop in gypsum production was due, was it not, to the substitution of the dolomite

(Testimony of Fred Melhase.)

in place of lime that previously had been used?

A. I don't know whether it was, or not. I would have to go back over our records to answer that.

Q. Can you ascertain that from your records?

A. I don't know.

Q. Well, I wish you would in the morning.

A. It may have been that we just did not have enough bittern to produce the amount of lime, the amount of gypsum in 1943 that we had in 1942; I don't know.

Q. As a matter of fact, in 1943 you produced more magnesium oxide than you produced in 1942?

A. I don't know the relative amounts that were produced.

Q. Aren't there available records that would show that to you?

A. I can perhaps find out.

Q. Well, I wish you would.

The Court: How would you find out?

A. I think I can go to our plant superintendent and get his records.

The Court: Is the plant superintendent available?

Mr. Rosenberg: He is not here, your Honor.

Q. (Mr. Bennett): Dolomite is half calcium and half magnesia, isn't it?

A. Calcined dolomite is rough calcium oxide and magnesium oxide with a molecular basis.

Q. Going back for a moment to this plant, when you first went to work at Newark they had a plant actually in operation, that was not the pilot, in addition to the pilot plant, did they not?

(Testimony of Fred Melhase.)

A. Yes, they had the bromine plant in operation at that time.

Q. They were also manufacturing magnesium products at that time, too, weren't they?

A. No, they were not.

Q. Nothing but bromine was being produced?

A. Nothing but bromine.

Q. When was the first time that any magnesium produced at Newark?

A. As far as I know, the first magnesium products that were produced at Newark were the products that came from this pilot plant that they were building when I first went there, and that must have been in late December of 1933 or January of 1934.

Q. Did that pilot plant continue thereafter to operate in the production of magnesium products?

A. Yes, it continued to operate on an experimental basis.

Q. Was that the only plant to produce those magnesium products at Newark until 1937? [823]

A. That is correct.

Q. Did you have anything to do with those magnesium products that were produced at that pilot plant?

A. Yes. I worked in the pilot plant for about a year, as I testified before, and then in the research department in which we were experimenting.

Q. What was done with those magnesium products that were produced at that time?

A. I presume they were all sent out to different

(Testimony of Fred Melhase.)

companies for valuation. I don't know what all was done with them.

The Court: Did you testify they produced about 200 pounds a day?

A. No, I did not testify to that.

The Court: What did they produce, if you know?

A. I think it was in excess of that, a ton a day, or so.

The Court: What became of those products, were they marketed?

A. I think some of them were sent out on a trial basis to determine the economical value.

Q. (Mr. Bennett): What position did Dr. Seaton, Max Y. Seaton, have in connection with those plants at that time?

A. I believe he was a technical director at that time.

Q. He was your superior, wasn't he?

A. Yes.

Q. You were operating under his general direction? [824]

A. I think there were two or three others along the line between myself and Dr. Seaton.

Q. You have seen this article by Dr. Seaton, published in 1941, entitled, "Bromine and Magnesium Compounds Drawn From Western Bays and Hills"?

A. I believe so.

Q. Published in 1931. That was published in "Chemical and Metallurgical Engineering, November, 1931."

(Testimony of Fred Melhase.)

A. Yes, I have seen reprints of it.

Q. I direct your attention to this statement at page 640, under the title "Other Salts Now Recovered.

"The present magnesium chloride market, which can logically be served from a Pacific Coast plant will absorb but a fraction of the total magnesium values present in the bittern now being received, which quantity is regularly increasing as salt consumption of the West Coast steadily grows. Accordingly, after extensive laboratory investigation and some two years' pilot operation, a small plant for recovery of these values in other forms is now in production and a large plant is being engineered."

Do you know what small plant it was that Dr. Seaton referred to that was engaged in the manufacture of magnesium chloride or magnesium products?

A. I never saw that plant, myself. I presume that it was a very small scale pilot plant, the next step in the investigation [825] of this process after some of the laboratory work had been done; in other words, it was just the bathtub stage.

The Court: In any event, you know nothing about it? A. I know nothing about it.

Q. (Mr. Bennett): This control laboratory where you work now, Mr. Melhase, is engaged in analyzing, sampling and testing products other than gypsum, is it not?

(Testimony of Fred Melhase.)

A. Yes. I am more or less a director of that laboratory.

Q. What other things does the laboratory do other than testing these samples of gypsum?

A. They test samples of magnesium oxide as well.

Q. Are there other products manufactured down there now other than the base product magnesium oxide?

A. And gypsum.

Q. And gypsum?

A. Those are the two products that are being manufactured at the present time.

Q. Are there various forms of the magnesium oxide and further refinements of that that are being produced there?

A. Yes, there are a number of different forms of magnesium oxide which we produce.

Q. That requires further and various forms of processing, does it not? A. That is correct.

Q. You are concerned with all of those various other products [826] that are being produced out of magnesium oxide, aren't you?

A. Well, they are not produced out of magnesium oxide. They are magnesium oxide of different forms which are produced.

Q. Different forms. How?

A. We have what we call S-99, S-90, which are refractory magnesium used in making bricks for open-hearth furnaces, lime kilns, and such. They are very high temperatured bricks. We make a

(Testimony of Fred Melhase.)

product called Remosil, which is used in water softening, Magnesium oxide, which we call 2661, used for chemical purposes, the manufacture of Epsom salts and so forth. A number of products what we call 2663, 2662, 64, 65, that have a variety of chemical uses.

Q. All of those products that are used as pharmaceuticals or other scientific chemical purposes require analysis and testing, do they?

A. Yes. We don't produce all of those products at one time, however.

Q. The tests that you made of the gypsum are the same tests that you made over a long period of time, are they not? A. That is correct.

Q. In other words, you want to test the gypsum content and the other requirements set forth in the contract, you have generally used the same type of test for ten or fifteen years now?

A. Yes.

Q. Have there been any new or different techniques of testing [827] used through these years?

A. Oh, may have been refinements through the years.

Q. But approximately the same procedure is followed in each batch that you examine?

A. That's right.

Q. You understand that similar tests were made by Pacific Portland Cement Company, don't you, in their laboratory?

A. I presume they do, yes.

Q. How many people work for you in that laboratory?

(Testimony of Fred Melhase.)

A. About a total of 17, including the janitor and the chemist in charge of the laboratory, and his assistant, and other chemists and technicians, about 17.

Q. The testing of the gypsum is relatively a small part of the activities of this laboratory, isn't it, in so far as the time consumed?

A. Well, I don't know whether it is a minor part, or not. It is perhaps between five and ten percent of the total work, maybe a little more.

Q. You did not keep any time record of the amount of time in the laboratory that is devoted to gypsum tests? A. Yes.

Q. You mean you have time cards showing precisely the amount of time of your laboratory man hours that were put in on gypsum testing?

A. Yes. Each one of our people in the laboratory keeps a [828] record of his time which he spends, two hours on gypsum, he puts that down, or if two hours on one of the various magnesium products that would be put down.

Q. So it is possible for you to determine at the end of any money or at the end of any year actually the man hours, a record of the actual man hours employed in testing gypsum?

A. I think that is correct. It would be a question for our accountants to answer, though.

Q. Do what?

The Court: For the accountants to answer.

The Witness: For our accountants to answer.

Mr. Bennett: Well, I thought if he knew that himself——

(Testimony of Fred Melhase.)

The Court: Well, they keep time cards.

The Witness: We keep the time cards.

Q. (Mr. Bennett): Do you keep these on a monthly or annual basis?

A. Kept on a daily basis or weekly basis. The time cards are on a weekly basis.

Q. Do you have any summary or compilation of the time for any single period of a week, or a month, or a year showing the hours of time spent on gypsum?

A. No, I don't have those records.

Q. Does anyone have those records?

A. I assume our accounting department has; I don't know.

Mr. Bennett: Well, I would like to have those records from [829] counsel, if the court please.

Mr. Rosenberg: You seem surprised at this information, Mr. Bennett: It is all set forth in our answers to the interrogatories.

The Court: Is that all of this witness?

Mr. Bennett: Well, just one second, your Honor.

Q. During this first two weeks in September, or from September 1st to September 13th, 1946, was this sulphuric acid used in the operation down at the plant at Newark, as you testified that it has been used from the beginning of the time that you first had anything to do with that plant?

A. What was this period that you referred to?

Q. September 1st to September 13th, 1946.

A. I presume that the sulphuric acid was used at that time, unless the plant was actually shut down.

(Testimony of Fred Melhase.)

Q. Do you know at any time since that plant has been manufacturing magnesium oxide or manufacturing gypsum that they have failed to use the sulphuric acid at the initial stage of operation?

A. Only in that one test in which I mentioned.

Q. That was merely a laboratory test and not the operation of the plant?

A. No, that was a plant test.

Q. When did that occur?

A. In October of this year.

Q. Just one day? [830]

A. No, there were several days, as I recall.

Q. Several days. Was any report written up of that test?

A. I don't believe there was any formal report.

Q. Did you make any report concerning it?

A. No, I did not.

Q. No record was made of the test?

A. I think there were some records kept.

Q. Did you keep a record of the test?

A. I did not——

Q. Who did?

A. (Continuing): ——keep any personal record of the test. One of my men followed the test, and I did observe the test which was primarily an observation test.

Q. But you did not make any report or memorandum of what was done and what was observed?

A. I think there are some memoranda on it. I am not positive.

Q. Have you not seen it?

(Testimony of Fred Melhase.)

A. One of my men got out a short memorandum regarding the test.

Q. Do you know where that is now?

A. I believe we have one in our files at Newark.

Q. Well, I would like to see a copy of that, please, your Honor, for the purpose of further cross-examination of the witness. But other than that test, Mr. Melhase, ever since you have been down at that plant they have always used sulphuric acid in the initial step of treating the bittern water [831] as it came from the holding pond, have they not? A. I think so, yes.

Q. And any time when gypsum was not being manufactured during that period they still continued to put in the sulphuric acid, did they not?

A. That's right. Those instances were of only a short duration, however.

Q. Well, short or long, they never stopped putting in the sulphuric acid at that first stage merely because they were not manufacturing gypsum, except on this test period in October, 1947?

A. That's right.

Mr. Bennett: Now, I think that is all we have, your Honor.

The Court: How much time do you want, Counsel?

Mr. Rosenberg: I only have a few questions.

Redirect Examination

Q. (Mr. Rosenberg): Let me ask you, Mr. Melhase, where is that sulphuric acid added?

A. That is added as the bittern is pumped into the concrete feed ponds.

(Testimony of Fred Melhase.)

Q. Then the bittern goes into the ponds?

A. Yes; it is introduced into the feed system as it flows into the feed ponds.

Q. When the bittern is drawn off to go to the gypsum department, it is drawn from what source?

A. From those concrete feed ponds.

Q. I may have asked you before, but I am not sure, will you state whether or not it is necessary to make gypsum in order to make magnesium oxide?

A. It is not necessary to make gypsum, no. It is necessary to take the sulphate out only.

Mr. Bennett: Wait a minute. May I have that answer read?

(The answer was read by the reporter.)

Q. (Mr. Bennett): What is the difference?

Mr. Rosenberg: Well, you ask the witness.

Mr. Bennett: I beg your pardon.

Q. (Mr. Rosenberg): Mr. Melhase, is there gypsum in the bittern?

A. No, there is no gypsum in bittern.

Q. Gypsum is not contained in the bittern as it comes into the plant?

A. No, not as such.

Q. Assume that you would discontinue for one reason or another the making of magnesium oxide at the plant, would it be necessary for the production of gypsum to have these mixing tanks and precipitation tanks and the other equipment that you mentioned as being utilized in the production of gypsum?

(Testimony of Fred Melhase.)

Mr. Bennett: I don't know that the proper foundation has been laid for that.

The Court: I will allow the question. [833]

The Witness: Yes; all that equipment would be necessary even though magnesium was not produced.

Q. (Mr. Rosenberg): Assuming you would continue to produce gypsum. A. That's right.

Q. Has there been any time during the period that you were employed at this plant prior to the time, prior to 1945, that they were not producing discontinued, was there any period prior to that time, prior to 1945, that they were not producing bromine at the plant?

A. No, not that I recall; at no time prior to 1945 did they discontinue the production of bromine.

Q. Let me ask you this: If you were going to discard the gypsum when it is precipitated out of the bittern and not processed, draw it off and filter it and dry it and grind it, would you require the filter?

A. No, you would not require the filter.

Q. With reference to the use of dolomite, in 1943 did you continue using dolomite, or was it used for some period of time, limited time in 1943; do you know?

A. The use of 100 percent dolomite was limited for a few months in 1943 and a few months in 1944. After that time, however, we went back to a mixture of lime and dolomite.

(Testimony of Fred Melhase.)

Q. So for the period of time in 1943 that you did use——

A. I think it was from about July or August of 1943 through January or February, 1944. [834]

Q. With reference to keeping records of time spent in the laboratory in connection with the various products, does that apply to yourself and the laboratory superintendent as well or only as to the technicians who work in the laboratory?

A. Primarily to the technicians who work in the laboratory. I do not make a breakdown of that sort myself.

Q. How about the laboratory superintendent? Do you know if he does?

A. I do not believe that he does, no.

Mr. Rosenberg: That is all.

Recross-Examination

Q. (Mr. Bennett): If you stopped this laboratory control work in your laboratory, it would be necessary to continue the laboratory just as you have it set up now, would it now, Mr. Melhase?

A. It would not be necessary to have as many people in the laboratory as we have now, no.

Q. You said that approximately 5 per cent of the total time of that laboratory was taken up——

A. I do not know what the exact percentage is. I think I said between 5 and 10 per cent or maybe a little more.

Q. I am going to read to you the answer of the defendant to interrogatory 10G:

(Testimony of Fred Melhase.)

“Indirect charges shown on Exhibit F would have been incurred if no gypsum had been produced but in less and unascertainable [835] amounts.”

Assuming that the laboratory control is one of the indirect charges shown on Exhibit F, do you agree with that statement, that if no gypsum had been produced, these laboratory charges would have been incurred but in a lesser and unascertainable amount?

A. Well, direct labor would have been ascertainable. Whether the laboratory superintendent's time would have been ascertainable, I do not know. That is something for the accountants to figure out, I think.

Q. Do you have any single laboratory technician who works solely on this gypsum?

A. Not solely on the gypsum, but when he does work on the gypsum he does put down his time.

Q. Prior to 1943, did you ever use any dolomite in this process or manufacture down at Newark?

A. We may have used a little bit in 1942. I am not certain. I think we had used anywhere from 10 to 25 per cent in 1942.

Q. In this method of testing, according to your understanding, these batches by weekly composites according to the standards of the American Society for Testing Materials?

Mr. Rosenberg: Are you talking about the samples now or the methods of testing?

Mr. Bennett: The samples he has already testified to.

(Testimony of Fred Melhase.)

The Witness: I do not think it says in those methods by [836] the American Society of Testing Materials, how frequently you should test a product.

Q. (Mr. Bennett): The principle is to test each batch of product to determine whether each batch is according to standard, isn't it?

A. Yes, but we do not make the gypsum in batches. It is a continuous process.

Q. And your method is simply to take samples weekly and make——

The Court: Daily and weekly.

The Witness: We take them daily.

Q. (Mr. Bennett): And then the composite of these samples and test the composite, is that correct?

A. We do not actually test the composite. We test the 8-hour samples, the shift samples, but we do not perform any analysis on the composites.

Q. Do you ever advise Pacific of the results of your 8-hour samples?

Mr. Rosenberg: Just a moment. To which I will object on the ground it is incompetent, irrelevant and immaterial.

The Court: The objection is sustained. Now we will adjourn. My patience is exhausted, gentlemen.

Mr. Bennett: I am sorry.

The Court: We will adjourn until 10:00 o'clock tomorrow morning.

(Thereupon an adjournment was taken until tomorrow, Wednesday, December 24, 1947, at 10:00 o'clock a.m.) [837]

Wednesday, December 24, 1947, 10:00 o'clock a.m.

The Court: Pacific Portland Cement Company v. Westvaco.

Mr. Rosenberg: Shall we continue with Mr. Melhase or do you wish to recall Mr. Barrows for cross-examination, Mr. Bennett?

Mr. Bennett: Whichever the Court would prefer.

The Court: Didn't we get through with him?

Mr. Rosenberg: I do not believe so. You will remember Mr. Barrows was to return this morning for further cross-examination and I believe that Mr. Bennett was in the process of cross-examining Mr. Melhase.

The Court: Didn't we get through with the last witness on the stand?

Mr. Bennett: There are two or three questions, Your Honor.

The Court: Call him.

FRED MELHASE

was recalled as a witness on behalf of the defendant, and having been previously duly sworn, testified as follows:

Cross-Examination (Continued)

Q. (Mr. Bennett): Mr. Melhase, one matter that I would like to clear up: You said at this stage, or the lower part of the chart, Plaintiff's Exhibit 16 for identification, you added either quicklime or dolomite instead of calcium hydroxide. Do [838] you recall that? A. That is correct.

(Testimony of Fred Melhase.)

Q. As a matter of fact, quicklime when added in solution, becomes calcium hydroxide, does it not? When you add quicklime with water, it forms calcium hydroxide, doesn't it?

A. In this case I do not know whether the quicklime goes first to calcium hydroxide and then to magnesium hydroxide or whether the reaction takes place directly from the calcium oxide to magnesium hydroxide. That is a very fine point.

Q. But as an ordinary matter of chemistry, the addition of water to quicklime forms calcium hydroxide, doesn't it? A. That is right.

Q. You just do not know what the reaction is here?

A. You would get an entirely different type of precipitate, however, if you added hydrated lime to this bittern than you do when you add quicklime or dolomite to it.

Q. When you add calcium chloride to the bittern water, it forms this precipitation of the calcium sulphate or gypsum, part of that settles to the bottom and some of it still remains in suspension, does it not, in the settling tank?

A. Very little remains in suspension.

Q. Well, some still remains? It does not all go flat to the bottom and form there in a solid mass, does it?

A. Oh, I would say 99-plus per cent of it goes right to the bottom, yes. There is a little very fine suspended matter in [839] the bittern, in the magnesium chloride there.

(Testimony of Fred Melhase.)

Q. Through the fluid into the settling tank?

A. Yes, when the magnesium chloride bittern overflows the settling tank.

Q. I asked you yesterday in the period of September 1 to September 13, 1946, whether any gypsum had been produced or any gypsum analyzed in production. You said you did not know. Have you since investigated and determined from your laboratory records or any other records or any other source of information as to whether gypsum was actually produced and samples tested, daily samples, 8-hr. samples during that period of time?

A. I have not had a chance to get back to the plant and check any records since I was here yesterday.

Q. You have made no attempt to do that either by telephone or otherwise? A. No.

Q. Would your records show whether there was any calcium sulphate or, rather, gypsum produced during that period September 1 to September 13, 1946; also whether there were any samples tested or analyzed in your laboratory during that period?

A. I think the plant records and laboratory records would show that.

Mr. Bennett: I presume, counsel, there is no need of a formal demand at this time to have the records for that period of time produced? I suppose you can supply them at a later [840] convenient time. I would ordinarily like to preserve further cross-examination of the witness until they

(Testimony of Fred Melhase.)

are produced, but I won't press the matter at this time.

Q. Do you know, so far as this bittern water that comes in, the nature of the contract or the arrangements you have with the Leslie Salt Company to obtain that bittern? A. No, I do not.

Q. Your company has, does it not, an agreement whereby you take all the bittern produced by the Leslie Salt Company?

A. I do not know exactly what that agreement is.

Q. As I understand it now, you have down there being furnished to you more bittern than you need in your overall operation, isn't that a fact?

A. No, I would not say that is true. I believe I stated yesterday that we have more magnesia values in the bittern than we need. However, we do process all the bittern and make gypsum, all the gypsum that we can. Every batch of bittern goes through our plant and gypsum is produced from it.

Q. But up to recent date you were endeavoring to produce down at your plant all the magnesia products that you could produce, weren't you?

A. Oh, we probably were producing back in 1941 or thereabouts—I guess we were using all the magnesium values in the bittern.

Q. I am asking now if it is not a fact that up to and including 1945 you were endeavoring to produce all the magnesia that [841] your plant had a capacity to produce.

A. Well, I do not think that we were using all the magnesia in the bittern at that time.

(Testimony of Fred Melhase.)

Q. That was not the question. You were endeavoring, were you not, in your operation down at the plant there to turn out, produce all the magnesia products that the plant was capable of producing, at least up to and including 1945?

A. I would not say that that was so. It depends on our sale of magnesia. I do not know exactly what that is.

Q. Oh, your degree of production, then, depends upon your sales outlets at the particular time, is that so? A. Partly, I presume.

Q. You knew that during the wartime there was an unlimited demand for magnesia products and that the War Department was asking you folks to step up your production, don't you?

A. Certain products, yes.

Q. And that was one of the reasons why you started using dolomite to increase your magnesia output, wasn't it?

A. We did increase it, but whether we increased it to the maximum capacity of the plant I am not in a position to say.

Q. You just don't know. That is all.

Redirect Examination

By Mr. Rosenberg:

Q. Mr. Melhase, do you know this: In the year 1943 did the Westvaco plant at Newark process all the bittern that it obtained from the Leslie Salt Company? [842]

A. We have always processed all the bittern that

(Testimony of Fred Melhase.)

we could obtain from the Leslie Salt Company, yes.

Mr. Rosenberg: That is all.

Mr. Bennett: One moment, and then I will be through.

Recross-Examination

By Mr. Bennett:

Q. How long were you associated with Mr. Stanley Barrows when he was president of the California Chemical Corporation?

A. Oh, I believe I have known Mr. Barrows since about the time I went to work for the company in 1933.

Q. And you had frequent contacts down there with him at that time?

A. No, I would not say that I had frequent contacts.

Q. He was in charge of the whole management of the California Chemical Corporation, however, was he not? A. He was president of it.

Q. I am going to direct your attention to a statement that Mr. Barrows made in his deposition on October 25, 1947, reading at the bottom of page 31, line 20:

“Q. Are you familiar with the chemical process involved in the making of these products: magnesium oxide, and bromine, and ethylene-dibromide and gypsum?

“A. Not the chemical processes; just in a general way.

“Q. And do you know whether sulphuric acid is used in the manufacture of those products? [843]

(Testimony of Fred Melhase.)

“A. Yes, I know we buy lots of it; we have for years bought sulphuric acid.

“Q. And that sulphuric acid is necessary in the process of manufacturing these products, such as magnesium oxide and bromine?

“A. Yes, and on the gypsum also; it is used in the whole process.”

Do you agree with that statement by Mr. Barrows?

A. No, I do not believe that I do from a technical standpoint.

Q. One other question and then I am through. You stated yesterday you were now furnishing a composite weekly sample of the gypsum to Pacific State, please, how long that has been carried out, that is, how long have you been furnishing a weekly sample?

A. I do not actually recall. For the last year or two, I think.

Q. Prior to that what sort of samples did you furnish?

A. I do not know whether they were daily samples or car samples or just exactly what they were.

Q. They were car samples, weren't they, Mr. Melhase?

A. I can't say definitely. I have never paid an awful lot of attention to the samples that were furnished Pacific Portland.

Q. You just do not remember that?

A. Merely what they requested, I presume.

(Testimony of Fred Melhase.)

Q. That was a minor part of your responsibilities? [844] A. That is right.

Q. And you just did not pay much attention to that, is that correct? A. That is correct.

Q. This plan that you now have of taking and furnishing a composite weekly sample of your week's production is something that has just been started by the company in the last year, isn't it?

A. I couldn't say how long that has been going on.

Q. You said a while ago——

A. Recently, yes, the last year or two.

Mr. Bennett: That is all.

The Court: Step down.

STANLEY H. BARROWS

called as a witness on behalf of the defendant, and having been previously duly sworn, testified as follows:

Cross-Examination (Continued)

By Mr. Bennett:

Q. Mr. Barrows, yesterday in your testimony you stated that after you had submitted to Mr. Colton your letter of September 18, 1936, and the enclosed draft of the proposed agreement, that several discussions were had, and you said one phase of this discussion was with reference to the cancellation clause. You recall when your deposition was taken on October 25, 1947, don't you? [845]

A. Yes.

(Testimony of Stanley H. Barrows.)

Q. At that time you were asked, were you not, to relate the conversations you had had with Mr. Colton with reference to this matter of prices and costs? Do you recall that?

A. In a general way, yes.

Q. You also recall that in your deposition in that connection you did not say anything about any discussion having to do with the cancelation clause, did you?

A. I do not recall. I think the deposition would show that.

Q. I am going to ask you to read, Mr. Barrows, beginning at page 24, line 2, down to and including all of page 24 and 25.

A. This part about the loss of those memorandum papers is as far as you want me to go on 26?

Q. No, I only wanted you to read 24 and 25.

A. I have read 24 and 25.

Q. I will ask you whether this testimony was not given on your deposition, questions asked and answers given:

“Q. Well, at that time”—you were referring back to June 5 and September 18, 1936—“you were proposing that any increase in price by reason of any increase in cost should be limited to those increases in direct costs such as labor, supplies and/or materials and fuel? Wasn’t that so?”

“A. I wouldn’t think so, Gene. It is a starting point.

“Q. Well, did you have—

(Testimony of Stanley H. Barrows.)

“A. And I know we had a lot of talks on that afterward. [846]

“Q. Well, did you have any—withdraw that.

What talks did you have afterward, and with whom, concerning that?

“A. Mr. Colton and myself talked on numerous occasions.

“Q. You mean after——

“A. After this preliminary draft.

“Q. Of September 18th? A. Yes.

“Q. And what was said concerning that?

“A. I couldn't answer that.

“Q. You have no recollection?

“A. No. I know that we talked on a lot of points, because this final contract, I believe, would show that we didn't follow this.

“Q. You don't recall anything specifically said by you——

“A. I can remember discussing the cost matter, I can remember discussing this amount clause, how much they were to get, you know; I can remember discussing in a general way chemical specifications to this extent: He said, “Well, what are your chemical specifications?” I said, “I don't know a darned thing about chemicals,” I said, “You pick a man who attends to those things from your organization and I will designate a man from the California organization and let them determine what your chemical specifications should be.” We did put in quite a lot of words in arriving at that point, but what the words were I couldn't tell.

(Testimony of Stanley H. Barrows.)

Q. But you don't have any recollection of any specific [847] discussions with Mr. Colton or anyone else connected with or representing the Pacific Portland Cement Company with reference to the nature or type of costs that would be such as to entitle you to an increase in price?

“A. Well, what would entitle us to an increase was what we would finally decide upon, and we did talk that thing out and it took quite a long time, and that is what resulted in their finally changing the thing to just ‘cost of production.’ My thought was to ‘leave it to the accountants, what cost of production is.’

“Q. Do you recall anything specifically that Mr. Colton said with reference to that?

“A. No.

“Q. Do you recall anything specifically that you said, other than ‘leave it to the accountants, what the cost of production is’?

“A. That is my final remembrance.”

Now, has your recollection changed as to these discussions, Mr. Barrows, by reason of any new facts, memoranda, documents or other things that have come to your notice or attention since your deposition was taken this past October?

A. Not from any—

Mr. Rosenberg: Just a moment, Mr. Barrows. Mr. Bennett, you do not want the witness to understand that you have read to him all of the deposition pertaining to the discussion of that subject with Mr. Colton, do you? [848]

(Testimony of Stanley H. Barrows.)

Mr. Bennett: Well, no. The deposition is full of other discussions about other matters.

Mr. Rosenberg: No, the same matter. Read from page 21, line 1.

Mr. Bennett: I will be glad to go back to that early part if you wish, counsel. I thought I would save time under the admonition of the Court and get things moving faster.

The Court: Do anything but try the Court. Proceed.

Mr. Bennett: I am sorry, Your Honor. I meant no reflection.

The Court: I have been about so long, no matter what happened, it would not disturb me.

Mr. Bennett: As counsel has asked, I will read—you want me to start where?

Mr. Rosenberg: As long as the Court does not understand, or the witness does not understand you have purported to read from his deposition everything he said about the discussion with Mr. Colton on the subject of cost of production.

Mr. Bennett: I will go back. Where do you consider it starts?

The Court: Page 21, he said.

Mr. Bennett: What part? It starts with an answer. We would have to read back at the bottom of page 20, I presume:

“Mr. Bennett: Q. Will you state what that bone of contention was? [849]

“A. Well, it is pretty hard to remember, but I do recall this: In one case, in one of the drafts

(Testimony of Stanley H. Barrows.)

they submitted—well, I don't even know what you have in your file. You may have that. If I could see it, I could tell better, but we got to discussing what would be costs. I didn't want to limit it to the first items that we had outlined, because we got to figuring that we were going to have to put up the plant to make this gypsum. At first we thought we could put in a drier and then later it transpired we would have to put up a plant and put in equipment, and Colton put in a paragraph that the production costs—we were to have the right to decrease—keep records of the costs of production in form satisfactory to Pacific, and I said, "No, we can't do that, because I don't know what 'form satisfactory to Pacific' might mean. It might mean anything." And then I suggested, I countered with a "form in keeping with good accounting practice"—accepted practice, and I left that note with Williams, and I think—again it is awfully hard to remember these things ten years ago, but I think they said, "Well, we will just put in 'cost of production' and that will cover it. It is too involved to try to outline what every cost of production is." This is my recollection."

Mr. Rosenberg: I think that covers it.

Mr. Bennett: That is preliminary, Your Honor, to the further specific examination which I directed and which I first [850] read to the witness, and in which he said it was his suggestion to put in cost of production. Leave it to the accountants.

Q. Your testimony, including the questions asked

(Testimony of Stanley H. Barrows.)

and the answers given, was had on the 17th day of October of this year when you were a witness, Mr. Barrows?

A. If it is in there. I do not remember the date. I would have to check it.

Q. You have just read it, have you not?

A. Yes.

Q. And you gave that testimony at that time?

A. That is correct.

Q. Since that date have you located any records, papers or documents that contain any information or memoranda as to what was said between you and Mr. Colton with reference to this contract?

A. No, I have not. However, when this deposition was taken that letter of June 18, that form of contract submitted on September such and such a date— I guess it was June 5 and September 18—

Q. You are referring now to your letter of June 5?

A. Yes, which was shown to me as you were questioning me.

Q. And your letter of June 18?

A. And the final contract was the first time I had looked at them for a long time, and it is pretty hard to remember out of [851] a clear sky just what you said. In other words, if that had been correctly answered, I would say we discussed every paragraph in that contract.

Q. As a matter of fact you did?

A. Back and forth during that period, so that would cover every paragraph.

(Testimony of Stanley H. Barrows.)

Q. You discussed almost every paragraph?

A. Yes, we did, including all of these things we have talked about.

Q. You even changed the base of comparison or, rather, discussed changes in the basis of raises. Originally you had proposed that any increase in cost would be an increase over the cost of the base period?

A. Well, I do not not remember that, but whatever is in the contract we did discuss and whipped it out.

Q. But at the time your deposition was taken the great bone of contention was Pacific's or Colton's suggested request that you keep your books of account in a form satisfactory to Pacific, wasn't that it?

A. No, I would not say that that was the great bone of contention. The bone of contention was how we would arrive at cost of production. During that period, if I may deviate slightly, our process in making contracts was to get first a rough draft, such as we submitted on the 18th, which goes to Colton. Then a copy of that goes to our different departments: [852] our accounting department, our sales department, and I asked for suggestions how the different clauses could be more properly or more advantageously written, and our accounting department might have come back—as I say, I can't remember twelve years—but they might have come back and called my attention, "Over the long period of the contract you are not covering costs;

(Testimony of Stanley H. Barrows.)

that can be very troublesome.” And so that is the bone of contention. That is what brought up the cost.

Q. There was a bone of contention that Pacific suggested you keep your books in a form satisfactory to them?

A. That is right, that was about the third or fourth draft—the third draft, let us say.

Q. You objected to that? A. Sure.

Q. But you can't recall now on June 5, 1936, when you first made the proposal to Pacific, all that you were concerned in a price protection clause was advances in labor, materials and power.

A. I remember that those were the items that were mentioned.

Q. Within a few months later, in September when you wrote your letter of September 18 and submitted a proposed draft, the contract that had been prepared by your lawyer—

A. That is right.

Q. Again, all that you were proposing was price protection against increases of the direct cost of labor, and so forth? [853]

A. That is right, used as a starting point, however. That does not mean a final—

Q. You talked to your department heads and other people between June 5, 1936, and September 18, 1936, hadn't you, Mr. Barrows?

A. Not in regard to the contract. That first con-

(Testimony of Stanley H. Barrows.)

tract that you see, September 18, is the copy that would go out to the different department heads and then they would come back and make suggestions.

Q. As I understand it, then, your view, or at least what you were contending with Colton, according to your final recollection, was any actual increase in the cost of production or the cost of manufacture of this byproduct gypsum would be left to the accountants to determine; is that what you had in mind?

A. I would think that is essentially correct, following accepted accounting practice.

Mr. Bennett: Thank you, Mr. Barrows. That is all.

Mr. Rosenberg: No further questions.

The Court: You may step down. [854]

DAVID WATT,

called as a witness on behalf of defendant; sworn.

The Clerk: Will you state your name to the court?

A. David Watt.

Direct Examination

By Mr. Rosenberg:

Q. Mr. Watt, where do you reside?

A. Hayward, California.

Q. By whom are you employed?

A. Westvaco Chlorine Products Company.

(Testimony of David Watt.)

Q. In what capacity? A. Office manager.

Q. How long have you been in the employ of that company? A. Since August 1, 1937.

Q. In what capacity were you first employed?

A. As an accountant.

Q. How long did you continue in that capacity?

A. Until 1941.

Q. What duties did you take up in 1941; did you become office manager?

A. No; assistant office manager.

Q. When did you become office manager?

A. I became acting office manager in October, 1944, and was named office manager in January, 1945.

Q. What are your duties as office manager?

A. General supervision of the accounting department. [855]

Q. What training and experience have you had in the accounting field?

A. Well, prior to coming to this country I was an accountant and auditor in Africa for ten years. I came to this country in 1929 and was employed by the New York Telephone Company. In 1931 I came to California, and worked for Arthur Anderson & Company, certified public accountants, Eugene Berger & Company, certified public accountants. I also worked for Elliot Nugent, actor and director at Metro-Goldwyn-Mayer, the Electograph Service Company. In 1933 I went to work

(Testimony of David Watt.)

for American Potash & Chemical Company, Trona, California. In 1937 I started working for Westvaco.

Q. What education have you had in accounting?

A. Well, I was educated in Scotland, at Skerry's College.

Q. Other than your accounting work and education, what experience have you had in cost accounting, other than your experience with Westvaco Chlorine Company?

A. I had some experience in Africa, but most of my cost experience has been with Westvaco.

Q. Have you brought with you your work sheets on these moisture credits? A. Yes.

Mr. Rosenberg: At this time I would like to offer in evidence, if the Court please, Exhibit H that was offered for identification. I wanted to compare it with the original. [856] There appears to be some typographical errors in there, but the same appear in the original, so apparently that is a true copy.

The Court: It will be admitted and marked, subject to any corrections you wish to make.

(Thereupon Defendant's Exhibit H For Identification was admitted and marked in evidence.)

(Testimony of David Watt.)

DEFENDANT'S EXHIBIT H

California Chemical Company
Mills Tower, 220 Bush Street
San Francisco

September 18, 1936.

Mr. J. H. Colton, Vice-President
In Charge of Operations
Pacific Portland Cement Company
111 Sutter Street
San Francisco

Dear Mr. Colton:

Enclosed herewith you will find copy of our first attempt to outline conditions in the proposed contract between our respective organizations, covering shell lime and gypsum.

I am leaving for the East the last of this month and should like, if possible, to get contract in final form and executed prior to my departure. I will be tied up on Wednesday and accordingly if you can get the matter in shape for discussion on either Monday or Tuesday, I can arrange to meet you on either of those days.

Will you, therefore, please telephone me when you are able to meet with me to further discuss conditions therein.

Very truly yours,

CALIFORNIA CHEMICAL
COMPANY,

By /s/ STANLEY H. BARROWS.

SHB:P encl. Dictated but not read.

(Testimony of David Watt.)

This Agreement, made and entered into this day of, 1936, by and between Pacific Portland Cement Company, a California corporation, (hereinafter called "Pacific") party of the first part, and California Chemical Company, a Delaware corporation, (hereinafter called "California") party of the second part,

Witnesseth:

Whereas, California uses certain oyster shell in the operation of its business; and

Whereas, California further contemplates erection of a plant located on Canal Head, at Newark, California, to manufacture magnesium oxide and other products by reacting calcined oyster shell and magnesium chloride, and as a result of said operations would also produce gypsum and calcined quicklime; and

Whereas, Pacific is desirous of selling oyster shell to California from certain deposits of oyster shell owned or controlled by said Pacific on the Bay of San Francisco; and

Whereas, Pacific is further desirous of purchasing from California certain parts of the gypsum and quicklime as and when the same is manufactured by California in the plant which, as is hereinabove set out, California contemplates erecting at Newark, California:

Now, Therefore, the parties hereto in consideration of the promises and covenants of the other herein contained, mutually promise and agree as follows, to-wit:

(Testimony of David Watt.)

1. That Pacific hereby grants to, and California shall have the right for the period of thirty (30) years commencing on the 1st day of January, 1937, and ending on the 31st day of December, 1966, at its own cost and expense, to enter upon, dredge for and remove from beds owned or controlled by Pacific situate on the Bay of San Francisco at such points or places on said beds as may be agreed upon by the parties hereto, all suitable oyster shell required by California in the operation of its plants situate in the State of California. In this connection it is understood and agreed that as California requires a certain type and quality of shell for its operations, that all dredging operations shall be at points or places on said oyster beds owned, leased or controlled by Pacific as will furnish or produce oyster shell suitable for the uses and operations of California, it being further understood that California shall be the sole judge as to the suitability for its uses and operations of all shell dredged, and in case no shell suitable for the uses and operations of California can be obtained from such beds, owned or controlled by Pacific, then and in that case this agreement shall be null and void upon California notifying Pacific in writing that oyster shell suitable for its purposes and operations cannot be obtained from the beds hereinabove referred to owned, leased or controlled by Pacific.

2. California agrees to pay to the order of Pacific at its office in the City and County of San

(Testimony of David Watt.)

Francisco, for all oyster shell removed from its properties, the following sums:

(a) 5c for each cubic yard of clean washed shell, dredged and removed by California from beds owned, leased or controlled by Pacific, situate in Alameda County.

(b) 20c per ton for each ton of washed shell, figured on a dry basis, dredged and removed by California from beds owned, leased or controlled by Pacific, situate south of Dumbarton, California. The method of determining quantities so dredged and removed by California shall be mutually agreed upon hereafter by the parties hereto, and said methods so agreed upon shall be made a part of the within agreement. All payments provided for herein shall be made by California on the 15th day of each month for the quantities dredged and removed by California during the preceding calendar month.

It is further expressly understood and agreed by and between the parties hereto that commencing with the 1st day of January, 1937, said California shall dredge and remove from the points or places agreed upon and designated by the parties hereto, all oyster shell consumed, sold or otherwise used by California in its operations during the term of this agreement, and further agrees to pay for said shell at the rates and in the manner hereinbefore set out. In case California should, during any year or years of this agreement, dredge and remove less than \$1800.00 worth of shell in accordance

(Testimony of David Watt.)

with the prices hereinabove set out, then California agrees on the 15th day of January after said year or years, to pay to Pacific the difference between the amount of shell removed, during said year or years, and the sum of \$1800.00.

California agrees that at the time of making payments for said oyster shell, it will deliver to Pacific full, true and correct statements of the account showing the amount of oyster shell removed from the properties of Pacific during the preceding month in accordance with the method of measurement agreed upon by the parties hereto. It is agreed that Pacific shall have at all reasonable times access to the books and accounts of said California relating to the amount of oyster shell removed from the properties of Pacific.

3. In case oyster shell suitable for the uses and operations of California cannot be obtained from the properties or oyster beds owned, leased or controlled by Pacific situate in Alameda County or south of Dumbarton, California, and suitable shell for the uses and operations of California can be obtained or produced from oyster beds owned, leased or controlled by Pacific situate in other parts of the Bay of San Francisco, then California shall have the option, if it so desires, to dredge for and remove oyster shell from said other properties or oyster beds owned, leased or controlled by Pacific situate in other parts of the Bay of San Francisco. In case said California should dredge and remove oyster shell for such other properties

(Testimony of David Watt.)

of Pacific as hereinabove set out, California agrees to pay to Pacificc for each cubic yard of washed shell so dredged and removed from said properties, said payment to be made at the times and in the manner hereinabove set out, it being understood, however, that the dredging of said other properties owned, leased or controlled by Pacific hereinabove referred to shall be at points or places designated by Pacific.

4. If and when California should erect the plant hereinbefore referred to on its properties situate on Canal Head, at Newark, California, and may produce in said plant gypsum or calcined lime, it is hereby agreed that California will sell, and Pacific agrees to buy from California, all gypsum produced by California during each year of the term of this agreement in excess of 3,000 tons per year, which California shall have the right to retain and to be disposed of in the manner hereinafter provided, but in no event shall the amount of gypsum agreed to be sold and purchased, as provided by this paragraph, exceed 20,000 tons per year.

Pacific agrees to pay to the order of California, at its office in the City and County of San Francisco, for all gypsum sold to Pacific by California, the following sum:

\$2.80 for each ton of gypsum loaded in bulk on cars at the Newark plant of California, said payment to be made on the 15th day of each month for the quantity shipped to Pacific during the pre-

(Testimony of David Watt.)

ceding calendar month. Pacific agrees that it will accept from California all gypsum produced by California during each month of the term of this agreement in excess of 250 tons per month, but in no event to exceed the amount of 20,000 tons per month; but in this connection it is agreed that on the first day of each month California will advise Pacific of the amount of gypsum which it contemplates producing during said month, and Pacific agrees to accept delivery of said amount by the end of the succeeding calendar month, subject, however, to the condition that Pacific shall not be required to accept more than 20,000 tons of gypsum in any year.

It is further agreed that California shall have the right to sell to persons or corporations other than Pacific up to 3,000 tons of gypsum per year for chemical, pharmaceutical and/or certain other scientific or industrial purposes, it being agreed, however, that California will not sell any of the gypsum produced in the plants hereinabove referred to for plaster, agricultural or building purposes.

5. If California should produce calcined lime in said plants hereinabove referred to from shell obtained and purchased from Pacific, California agrees to sell to Pacific during each year of the term of this agreement up to 9,000 tons of calcined lime produced in said plants, provided Pacific will agree to purchase from California a designated amount of tons of calcined lime each year

(Testimony of David Watt.)

for a period of years satisfactory to California, and which said agreement shall be entered into in writing and made a part of this agreement.

Pacific agrees to pay to the order of California, at its office in the City and County of San Francisco, for all calcined lime sold to Pacific by California, the following sums: \$6.50 per ton for bulk quicklime loaded on cars at the Newark plant of California; \$8.50 per ton for all hydrated lime in four-ply paper bags, loaded on cars at the Newark plant of California; said payments for said lime to be made on the day of each month for the quantity shipped to Pacific during the preceding calendar month.

Pacific agrees that it will give California at least thirty (30) days notice of the amount of bulk quicklime or hydrated lime that it will require for the succeeding calendar month, but in no event shall California be required to deliver more than 750 tons of calcined lime in any one month. It is hereby agreed by and between the parties hereto that Pacific will not use or sell calcined lime for industrial or chemical purposes, and that California shall have the right to continue to sell quick or hydrated lime for industrial and chemical purposes as at present, it being understood, however, that California will not sell or use quick or hydrated lime for construction or agricultural purposes, other than insecticides.

6. The prices hereinabove stipulated to be paid by Pacific for gypsum, quicklime and hydrated lime

(Testimony of David Watt.)

are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California, and it is therefore understood and agreed that in the event of price advances and labor, transportation, fuel or supplies resulting in an increase of 5% or more in cost above the first year's average direct cost hereinabove referred to, f.o.b. cars shipping point, then and in that event California shall have the right to increase the price to Pacific to the extent of the increase above the said average direct production cost for lime or gypsum.

7. It is further understood and agreed that as California is at present selling oyster shell for industrial, poultry and agricultural purposes, it shall have the right to continue to sell oyster shell for said purposes, and shall have the right to use shell purchased from Pacific for said purposes and uses; and in this connection it is understood and agreed that certain agreements exist between California and American Smelting & Refining Company for the sale and purchase of oyster shell to be used by said American Smelting & Refining Company in its plant at Selby, California, and that therefore California shall have the right to deliver and sell to said American Smelting & Refining Company oyster shell purchased and received by California from Pacific.

(Testimony of David Watt.)

8. In the event that any of the provisions herein contained, or any practice or action herein provided for would be in violation of any law or laws of any State, or of the United States with respect to restraints or trade or otherwise, then to that extent said provisions of this agreement shall be deemed to be of no force or effect whatsoever, and there shall be no obligation in such event upon either of the parties hereto to abide by or conform to said provision of this agreement.

9. California further agrees that during the term hereof all dredging operations conducted by California shall be done in a good and workman-like manner, and at the sole cost, charge and expense of California without cost, expense or liability whatsoever to Pacific, and California covenants and agrees to indemnify and hold harmless Pacific from any and all costs, liability, charges and expenses in any manner incurred by it in the performance of this agreement, and California further agrees that it will comply with all the rules and regulations of the United States or of the State of California covering said dredging, and further agrees to comply with all the rules and regulations required by the so-called Workman's Compensation laws and the so-called Accident Commission of the State of California, and agrees to fully indemnify and save harmless Pacific from any loss, liability, damage or obligation on account of any injury to any employee of said California engaged in said dredging.

(Testimony of David Watt.)

10. It is further agreed that California shall not be liable for any failure to make deliveries hereunder if such failure results from prevention or interference by exercise of governmental authority, acts of God, floods, embargo, war, civil uprisings, fire, strikes, lockouts, or any other causes beyond the reasonable control of California. Further, such failure shall in no way affect the obligations of the parties hereto under this agreement, except as to such orders which are not filled owing to such prevention or interference. If delay in fulfilling the same continues for more than thirty (30) days, then Pacific may procure its requirements elsewhere until California is ready to assume deliveries.

11. It is further agreed by the parties hereto that they will not, directly or indirectly, void their obligation hereunder by conducting their said business through a subsidiary or any affiliated corporation, or any corporation controlled, directly or indirectly, by either of them, their officers, directors or stockholders, or the relatives of any of them, and further agree that in the event that there is a transference through said subsidiary or corporation or person, that such corporation or person will comply with all the terms and conditions hereof as if a signatory party hereto.

12. It is further understood and agreed that California shall have the right to cancel this agreement at any time upon giving written notice to Pacific of its intention so to do, by delivering such written notice to said Pacific at least one (1) year

(Testimony of David Watt.)

prior to the date of cancellation. The said cancellation shall not become effective unless and until one (1) year's notice has been given, and during said year California shall have the right to continue to operate under this agreement.

13. It is further understood and agreed that any notice, order, demand or communication under or in connection with this agreement may be served upon California by personal service, or by mailing the same by registered mail in the United States Post Office, postage thereon fully prepaid and directed to California at 220 Bush Street, San Francisco, California, and may likewise be served on Pacific by personal service, or by mailing the same by registered mail in the United States Post Office, postage thereon fully prepaid and directed to Pacific at 111 Sutter Street, San Francisco, California.

Either party may change its address by notifying the other party in writing as to such new address as either party may desire used, and which same shall continue as the address of said party until further written notice; and it is further agreed that the mailing of said notice or notices as herein provided shall be a full compliance with the provisions of this agreement with respect to the giving of notices.

14. This agreement shall bind and inure in favor of the parties hereto, their respective successors and assigns.

In Witness Whereof, the said parties hereto have caused their corporate names to be hereunto subscribed and their corporate seals to be hereunto

(Testimony of David Watt.)

affixed by their respective officers thereunto duly authorized the day and year first hereinabove written.

PACIFIC PORTLAND
CEMENT COMPANY,

By

By

CALIFORNIA CHEMICAL
COMPANY,

By

By

Q. (By Mr. Rosenberg): Mr. Watt, have you prepared a statement from the records of the Westvaco Chlorine Products Company showing the deductions taken by Pacific Portland Cement Company pursuant to paragraph 5 of the contract?

A. Yes. This is the statement.

Mr. Bennett: Now, can't we reach it in a better way, Counsel? To shorten time, I am anxious to do that, but you objected to our witnesses construing the contract, and I would necessarily have to interpose an objection here, not knowing what testimony will be given.

Mr. Rosenberg: I said deductions by Pacific Portland Cement Company pursuant to the contract.

Mr. Bennett: I am sorry. Go ahead.

Mr. Rosenberg: Can't we stipulate to——

Mr. Bennett: Yes, if I can stipulate to anything to save time I will be glad to do it.

(Testimony of David Watt.)

Mr. Rosenberg: Let me offer a stipulation and see if you can agree with it: That from the inception of this contract [857] and up to the present time as shipments of gypsum have been received by Pacific Portland Cement Company, the Pacific Portland Cement Company apparently has made tests of the shipments in their laboratory and then based upon their analyses in making remittances to Westvaco Chlorine Products Company, they have deducted from the invoice, taken such deductions as they feel they are justified in taking pursuant to paragraph 5 of the agreement, and that in making such deductions Pacific Portland Cement Company has taken a credit of 10 cents per ton and a fractional part thereof for each per cent—strike that where I said “in making such deductions”—that in taking such deduction——

The Court: May I make a suggestion? I will take a recess for a few minutes. You can indicate what you expect to prove and let the other side know it, and probably you can save some time.

(Recess.)

Mr. Rosenberg: Your Honor please, paragraph 5 of the agreement provides in substance that in the event that the gypsum delivered under the contract shall not be within 2 per cent in gypsum content of the chemical analysis set forth as Exhibit A of the contract, then Pacific shall have the option either to refuse to accept and pay for the gypsum, or it may accept the gypsum and pay therefor 10 cents per ton less than the price provided for in the

(Testimony of David Watt.)

contract for each per [858] cent, which the gypsum falls below the chemical analysis.

Now, the chemical analysis provides for 97.51 gypsum content, and I think that the parties are agreed now that unless the gypsum content falls below that 2 per cent tolerance, or 95.51 per cent, no deductions are permissible under this paragraph.

Mr. Bennett: Yes, your Honor. I have stated that before, and that is our position now and in the future.

Mr. Rosenberg: It is the position of the defendant that if the gypsum content falls below 95.51 per cent that Pacific nevertheless is permitted to deduct 10 cents per ton for each full per cent that it falls below 97.51 per cent under the wording of the contract, that if it does so fall below 95.51 per cent that Pacific shall pay therefor 10 cents per ton less than the price provided for in the contract for each per cent which it falls below that percentage; Pacific, on the other hand, contends that if the gypsum content falls below 95.51 per cent then Pacific is entitled to a credit of 10 cents per ton, or fractional part thereof for each per cent or fractional per cent that the gypsum content is less than 97.51 per cent. That is right?

Mr. Bennett: That is correct.

Mr. Rosenberg: Now, I believe that we can stipulate that defendant, and I might say preliminarily that there is some difference between the parties by reason of the fact that the analyses of the gypsum which are made, or which have been

(Testimony of David Watt.)

made by Westvaco at its laboratory at Newark do not agree in all cases with the analyses made by Pacific at its Redwood plant,— [859] is that where they are made?

Mr. Bennett: Yes, that is correct.

Mr. Rosenberg: At its laboratory in the Redwood City plant, and, furthermore, as I say, there is a further difference by reason of these fractional amounts and it is admitted by Pacific that they have, as they state, through error taken certain deductions by reason of the 2 per cent tolerance and they tendered a check for \$539—

Mr. Kaapcke: \$539.24.

Mr. Rosenberg: \$539.24, which was not accepted for the reasons which have previously been stated.

I think we can stipulate to this, that according to the analyses of the gypsum made by Westvaco at Newark and not allowing any fractional per cent deductions, the records of Westvaco Chlorine Products Company show that for the period from December, 1940, to August, 1944, Pacific has taken deductions in the sum of \$514.91 in excess of those which they would be entitled to if the chemical analyses made by Westvaco are correct, and if we are correct in our interpretation of the contract that only full percentage deductions are permissible, and on the same basis for the period from September 25, 1944, to October 23, 1946, that Pacific has taken deductions of \$1653.20 in excess of what they would be entitled to according to our analyses, that

(Testimony of David Watt.)

is, Westvaco's analyses and Westvaco's interpretation of the contract. In other words, I think I can [860] state for those same periods Pacific admits that it owes——

Mr. Kaapcke: \$539.24.

Mr. Rosenberg: On account of——

Mr. Kaapcke: Inadvertence in not allowing tolerance in certain cases.

Mr. Rosenberg: Yes. Is there something you would like to add to that?

Mr. Kaapcke: Just a couple of sentences, I think. Your Honor, I would like to suggest to you and to Mr. Rosenberg that that stipulation is acceptable to us if it be modified by the addition of two further facts, and I think, Mr. Rosenberg, that you won't have any difficulty in agreeing on it. First, the tests made by Pacific at its Redwood City laboratory have been tests of samples furnished by Westvaco, which samples were taken at the Westvaco plant. The second supplement would be this, that according to Pacific's chemical analyses and if its analyses are correct after allowing for the \$539.24, which they concede to be due, Pacific's records would show that it has paid all sums it is obliged to pay under the contract. Is that satisfactory to you?

Mr. Rosenberg: Yes, that is all right. I should add that on a payment which Pacific made to Westvaco under date of November 10, 1947, they took a further credit of \$250.28 for shipments made during the month of September, 1947, where, ac-

(Testimony of David Watt.)

cording to their analysis, the gypsum content fell [861] below 95.51 and which amount is computed on the basis of fractional per cent, and which deduction, according to our analysis, is likewise not justified; in other words, our analysis shows that all of those shipments had the gypsum content exceeding 95.51, so that is in controversy as well.

Mr. Kaapcke: That supplementary amount, I take it, may be applicable under the stipulation we have just entered into.

Mr. Bennett: Except the problem of the 2 per cent tolerance is not present in that.

Mr. Rosenberg: That's right. I might say this, if the Court please, that counsel and I concede that the actual amounts of money involved, these are the matters that are involved in our counterclaim—are relatively, at least, unimportant. However, they involve a phase of the contract which if the parties are going to operate under the contract in the future the court is going to have to interpret. In other words, the court is going to have to interpret, is going to have to say what the contract means, whether the analyses made at Newark are to control or the analyses made at Redwood City are to control, and whether the contract says that the payments are to be for each per cent, that means each per cent or fractional per cent, so it is a matter of determination or interpretation for the future as well as for the purpose of determining the settlement of the present amount.

Mr. Bennett: I think in that case, your Honor, at the [862] risk of prolonging the time factor of

(Testimony of David Watt.)

this trial that I believe the real and only question other than the ultimate determination by the court as to whether the defendant is entitled to a credit of some \$1500 or whether it is entitled to nothing, that you are going to determine which laboratory was right.

The Court: How can that be determined?

Mr. Bennett: I hope we can save your Honor that burden. There is the more important thing involved here. If it is possible for us to resolve these little differences, differences that arise whenever a contract has a requirement for quality of content, that every effort should be made by counsel and the principals to resolve that matter and save this court the time that would be taken in testing which one of these laboratories is to be believed, and I hope that before the final submission of this case to the court that that determination of the actual cents and dollars in this comparatively trivial aspect will be resolved by the parties. Your Honor will further be called on to interpret the contract in one particular, in this relatively minor aspect, as to whether fractions of deductions are to be allowed, but I don't think we need to take up that aspect, we are all of us striving, under your Honor's admonition to get the case submitted as quickly as possible so when the trial is over I think maybe that aspect could be covered by argument or briefed at a [863] later juncture. I just want to indicate that parties in most instances of contracts involving measurements, and so forth, resolve their

(Testimony of David Watt.)

differences rather than burdening this court with sitting for hours and days to try that aspect of the matter. [863-a]

Q. (By Mr. Rosenberg): Mr. Watt, you are familiar, are you, with the fact that back in 1941 the price of gypsum under the contract was increased from \$2.80 a ton to \$2.98 a ton? A. I am.

Q. Can you state during what period of time Pacific Portland Cement Company paid Westvaco at the \$2.98 price?

Mr. Bennett: Isn't that all in the record by the stipulation?

The Witness: Up to 1945, some time in 1945.

Mr. Rosenberg: I think you are right. I think the record shows it was until some time in 1946.

Mr. Bennett: Subject, of course, to these little deductions that were mentioned here, that were gone into quite fully by Mr. Flick.

Mr. Rosenberg: I think perhaps we can stipulate also, can we, Mr. Bennett, that on October 16, 1946, Pacific paid Westvaco——

(Discussion between counsel off the record.)

Mr. Bennett: That is covered.

Q. (By Mr. Rosenberg): I believe you stated that you are the head of the accounting division of the Newark plant, are you?

A. That is correct, yes.

Q. There has been testimony to the effect that the depreciation that is charged to gypsum is computed on a straight-line basis, is that correct?

A. That is true. [864]